INTERSTATE SALES TAX COLLECTION

HEARING

BEFORE THE

SUBCOMMITTEE ON PROCUREMENT, TAXATION, AND TOURISM

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

WASHINGTON, DC, SEPTEMBER 27, 1994

Printed for the use of the Committee on Small Business

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INTERSTATE SALES TAX COLLECTION

TUESDAY, SEPTEMBER 27, 1994

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON PROCUREMENT,
TAXATION, AND TOURISM,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:30 p.m., in room 2359-A, Rayburn House Office Building, Hon. James H. Bilbray (chairman of the subcommittee) presiding.

Chairman BILBRAY. The subcommittee will come to order.

Today, the subcommittee will hear from a wide spectrum of witnesses on the impact and fairness of giving States the sales taxes incurred for purchases made by out-of-State mail order companies.

The subcommittee enters this hearing with an open mind but aware of a number of concerns that have been raised by the small business community in a number of areas.

Currently, the mail order sellers are exempt from collecting State sales taxes as a result of two Supreme Court decisions.

In 1967, the Court in National Bellas Hess *v.* The Illinois Department of Revenue held that out-of-State mail order firms and other direct sellers who have no physical presence in a State are under no obligation to collect and remit State sales and use taxes even if they do business in a State.

In 1992, the Court reaffirmed the 1967 decision but held that Congress may use its interstate commerce powers to uphold State collection requirements.

Legislation is pending in the Senate which would mandate out-of-State companies to collect sales taxes for goods delivered across State lines.

The first panel of small businesses will present their views to the subcommittee describing the price disadvantage they face when competing with mail-order companies.

Both small businesses and catalog firms sell the same quality products. However, a consumer can go down the street to the local computer store, price the system and compare it with the same system in the catalog. On most occasions, the local retailer, who must collect the sales tax, will be at a competitive disadvantage to the mail-order company who will not collect the tax.

The second panel, consisting of public officials, will enlighten the subcommittee on a potential revenue loss for local governments and the public educational system.

Two reports have been prepared to estimate the revenue loss. The Advisory Commission on Intergovernmental Relations esti-

mates that the revenue loss is around $3 billion a year. The Nathan Associates, on behalf of the Direct Marketing Association, concluded that the amount of uncollected sales tax on interstate mail order sales was $1.38 billion. Whichever figure you believe, it is a substantial amount of money.

Finally, the third panel will consist of a witness from the mail-order industry.

In addition, we have two letters that I would like to place into the record, one from Mamie Willis of Portland, Tennessee, and another one from a John Dix in Hilton Head, South Carolina, as consumers writing their letters, problems they came up with their own States in collect—having to pay the tax after the fact after they were told they did not have to pay on orders they made out of State.

[Chairman Bilbray's statement may be found in the appendix.]

Chairman BILBRAY. So, at this point, I would like to call on Mr. Sisisky, do you have an opening statement?

Mr. SISISKY. No, Mr. Chairman. But let me just say I appreciate you having this hearing today. I think it is an important subject. I get a lot of mail and a lot of comments about this situation.

A lot of the subcommittee is not here today because we are having a briefing on Haiti and, because of this, I have to have a special briefing this afternoon.

But let me just say I am delighted today to welcome Dr. James McNeer, who is a constituent of mine, the mayor of the city of Colonial Heights. He is not only mayor of the city but a good friend of mine. I know Jimmy is Provost and Dean of the Richard Bland College of the College of William and Mary, and I am delighted to welcome Dr. McNeer here today, Mr. Chairman. Thank you.

Chairman BILBRAY. Thank you.

Mr. Hilliard, do you have an opening statement?

Mr. HILLIARD. Mr. Chairman, thank you very much.

Chairman BILBRAY. Want to use the microphone?

Mr. HILLIARD. Mr. Chairman, I am very much concerned about mail order sales and how they affect the area in which we are concentrating. I am very interested in how they affect tourism, very interested in how they affect the local communities, as well as how they affect the State. I just want to commend you for bringing us together and bringing this topic before us. Thank you. Thank you very much.

Chairman BILBRAY. Thank you. If the gentleman desires, his entire statement will be put in the record.

Mr. HILLIARD. Thank you.

[Mr. Hilliard's statement may be found in the appendix.]

Chairman BILBRAY. At this time, I would like to call the first panel, starting with Joe Bookwalter, James Maurin, and Russell Cohen.

What we will do, gentlemen, is proceed through your testimony and then, at the end, we will open to the panel for questions. So, we will start with Mr. Bookwalter.

TESTIMONY OF JOE BOOKWALTER, BAKER APPLIANCE & VIDEO, INC., CARSON CITY, NEVADA

Mr. BOOKWALTER. Mr. Chairman and members of the subcommittee, my name is Joe Bookwalter. For the past 9 years I have been present and co-owner of Baker Appliance & Video, Incorporated, a 41-year-old business headquartered in Carson City, Nevada. In addition to our Carson City location, we have three other stores in Reno, Fallon, and Minden, Nevada. We currently have 37 employees.

Major home appliances "white goods" such as refrigerators, freezers, and ranges and the like—account for about 70 percent of our sales volume. The other 30 percent is attributable to consumer electronics products, such as TV sets, stereo equipment and video cameras and recorders.

In addition to operating my company, I have been an active member of my industry's national trade association, the North American Retail Dealers Association. I currently serve on NARDA's Board of Directors and am Vice President of the Association.

I am here this afternoon to urge your support for legislation such as the Tax Fairness for Main Street Business Act which would enable me to compete fairly with out-of-State companies that take advantage of a loophole in current sales tax collection laws.

My business has survived more than 40 years by providing exceptional service and knowledgeable sales consultants. But the proliferation of mail-order catalogs and toll-free telephone numbers in my industry has caused a very evident increase in the number of customers who use our store and our trained personnel to select their stereo equipment, video cameras and recorders, then buy them out of State. The fact that they are obligated to pay a State use tax on their purchase just doesn't seem to sink in.

Then when their technology equipment requires repair or adjustment, they bring it to our full-scale service department and expect warranty repair or free advice, which we are obligated by agreement to provide by many of our manufacturers. Our choice is to refuse to provide this service and eliminate the possibility of future sales to this customer or to cheerfully provide the service at our expense, which we do.

The interstate sales tax loophole also hurts our appliance business. Our stores are located near Lake Tahoe where it's not uncommon for home builders to spend $40,000 or more for kitchens in their new construction or major remodeling projects. The appliance share of that expenditure represents a major slice of business for our store if we weren't competing with suppliers across the border in neighboring California.

I know of many home builders who regularly purchase kitchen appliances from suppliers in the San Francisco Bay area. These appliances are sent bay common carrier to Nevada so that the seller does not have to collect our State's sales tax, which ranges from 7.5 to 8.5 percent.

Even though our contractors are obligated to pay our State's use tax on their purchases because they do not qualify as resellers under our State law, they rarely do so.

We have no problem competing on price. The tie breaker is the out-of-State seller's 7 percent or so sales tax advantage. Our State loses revenue, and I lose a major sale.

Because one of our stores is only 18 miles from the California border, someone might argue that we can take advantage of the same tax collection exemption afforded out-of-State competitors but we can't. We do a substantial amount of business in California. We are registered to collect California's State sales tax, and we do that on deliveries into their State.

This, then, is the trend: To leave out of the sales loop the Main Street merchant who supports the manufacturer by investing in his products. The merchant displays products in a retail store, with all the accompanying costs, attracts potential end users by expensive advertising, demonstrates products to the retail buyer, sometimes haggles over price, arranges financing, provides costly, highly skilled service and absorbs losses from uncollectible accounts.

As a Main Street retailer, I am further placed at a disadvantage by being required to collect State and sometimes local sales taxes while my out-of-State competitor has no such responsibility.

I know that this problem is not limited to the appliance and electronics business. I submit to you this unfair competition is a problem for all retailers and that it will become even more of a problem in the future with the growth of the so-called information superhighway and the increasing use of television and computer networks to sell merchandise.

Mr. Chairman, I appreciate the opportunity to come to Washington to explain to you and the members of this subcommittee firsthand a problem which confronts retailers like myself every day of the year. I strongly urge the Congress to pass the Tax Fairness for Main Street Business Act because it will remove an unfair advantage that my out-of-State competitors now enjoy and will enable me to compete on a more equal footing with these companies which are threatening the very existence of small businesses like mine.

Thank you very much.

Chairman BILBRAY. Thank you, Mr. Bookwalter.

[Mr. Bookwalter's statement may be found in the appendix.]

Chairman BILBRAY. Mr. Maurin?

TESTIMONY OF JAMES MAURIN, THE MAURIN-OGDEN/STIRLING PROPERTIES, MANDEVILLE, LOUISIANA

Mr. MAURIN. Mr. Chairman, members of the subcommittee, good afternoon. My name is James E. Maurin, and I am chairman and chief executive officer of Stirling Properties and managing partner of Maurin-Ogden properties in New Orleans, Louisiana. Combined, these two companies own and operate 42 shopping centers in the Gulf South, principally in Louisiana. These centers employ over 10,000 people in retail outlets, including discount and electronic stores and small mom and pop operations.

I would like to thank Chairman Bilbray and the members of the subcommittee for conducting this hearing today and for bringing greater focus to the tax avoidance situation which has created a marketplace inequity between traditional retailers and the direct marketing industry and in the process is threatening the future stability of the retail industry.

I am presenting my testimony today on behalf of the International Council of Shopping Centers, of which I am a member. ICSC is the trade association of the shopping center industry and its 25,000 members represent the owners, developers, retailers, financiers, brokers and all other professionals involved in the shopping center industry. There are over 39,000 shopping centers in the United States, and these centers generate in excess of $790 billion in retail sales in 1993 and remitted $33 billion in retail—in State and local sales tax receipts.

Shopping centers are also one of the biggest employers in this country, creating jobs for nearly 10 million people or roughly one out of every nine non-agricultural jobs in the U.S.

It is also important to note that the majority of shopping centers are not the mega malls that everyone writes about in the newspapers. In reality, nearly 5 percent of shopping centers occupy less than 200,000 square feet of leasable space, roughly equivalent to a medium-sized department store, drug store and maybe three or four other small retail outlets. Many of these small shopping centers are the very lifeblood of the communities in which they are located, and oftentimes they are the primary provider of tax revenue of the communities—on which the community survives.

Mr. Chairman, for many years Congress has searched for ways to break down the barriers to free trade and fair competition between the United States and its foreign trading partners. However, while we labor to eliminate foreign barriers, we largely ignore one barrier to fair competition which exists within our own borders.

The problem is simple—traditional retailers must collect State and local sales taxes on consumer purchases at the point of sale, but direct marketers are not required to collect—are not required to collect most of these taxes and instead are able to push the burden of sales tax remittance onto the shoulders of their customers.

This situation creates a tremendous pricing gap between traditional retailers and direct marketing companies, allowing direct marketers to sell comparable or at times identical merchandise at much lower prices simply because they do not have to tax on the 6 to 8 percent sales tax that is common in most areas.

But the problems created extend much further than the difference in price. This inequity affects employment and State and local economies to an extent that I imagine many members of this subcommittee fail to realize.

In practical terms, however, what does this tax avoidance mean on a typical retail sale? Let's say I go into a men's clothing star in Baton Rouge to buy a suit. The clothing store can buy the suit wholesale at $200 and decides to sell it for $300. If you add on the sales tax of 8 percent, the total cost to me is $324. However, a mail-order company that has no stores in Louisiana may offer the same suit, and, because they are not required to collect sales taxes, their total price is $300. Therefore, in order to stay competitive, the retail store will have to lower their sales price to about $275 so that their total price, including tax, is in the same range as that of the mail-order company.

What results from this one example is a domino effect for both the shopping center industry and local economies. Retailers are forced to operate on smaller or sometimes nonexistent profit mar-

gins. They hire fewer employees. Some are even forced to shut down. Fewer sales in local retail stores means a decrease in sales tax revenues available for use by State and local governments.

It is important, however, to examine the changing marketplace to realize the current and future impact of this tax inequity. Extraordinary changes are taking place in the retail marketplace, and the definition of shopping is undergoing a transformation. While the advent of expanded use of catalog merchandising and video shopping services, consumers are taking advantage of the luxury of shopping from the comfort of their own home in lieu of patronizing their hometown merchants.

The following points illustrates the striking changes that are taking place:

Over the past several years, the increase in retail sales in shopping centers has remained steady at under 5 percent per year, while retail sales for the direct marketing industry showed a more dramatic increase, up 14 percent from 1992 to 1993, and sales are expected to increase at 6 percent or better each year through the year 2000.

For 1993, the Direct Marketing Association reported sales of over $234 billion—or roughly 30 percent of the total retail sales generated by shopping centers. This recent addition of Entrepreneur magazine, February, 1994: Mail-order Mania. $234 billion industry delivers profits.

Although in 1993 over $33 billion in sales tax revenues were collected and remitted by retailers in shopping centers, State and local sales taxes were collected on a very small percentage of this $234 billion in sales by direct marketing companies.

As I stated earlier, nearly 10 million people in the U.S. are employed in shopping centers. The mail-order catalog industry, however, employs less than 200,000 people across the country.

Additional sources for so-called tax-free shopping are rapidly becoming available to consumers. Interactive television, on-line computer services and electronic shopping for airline passengers are just a few examples of direct marketing standards which stand to grab a greater share of the traditional retail market in the next decade.

These points illustrate the changing retail marketplace, but let's take a look at some of the problems caused by the tax inequity between traditional retailers and direct marketing companies.

The sales tax revenues generated by local retailers get funneled back into the local economies to fund services such as schools, police and fire protection and infrastructure improvements to roads and bridges. But a big mail-order company on the east coast oftentimes is not required to contribute sales tax revenues to cities and towns in Louisiana, even though they ship millions of dollars of merchandise each year into the State while taking full advantage of many of Louisiana's State and local services which are funded by State sales tax revenues.

In addition, as the pool of tax revenues available to State and local governments decreases, State legislators must look for ways to make ends meet. Oftentimes, they increase the tax on local companies for the privilege of doing business in the community. These

tax increases are another blow to the small retailer who is already having a hard time making ends meet.

Instead of increasing taxes, wouldn't it make more sense in this situation to ask everyone, including direct marketing companies who take advantage of the privilege of doing business in the community, to collect and remit State and local taxes at the point of purchase?

Most importantly, for every purchase that a consumer makes from an out-of State marketing company, another in-State retail job is put in jeopardy. Members of the subcommittee, how many of the constituents in your district receive a paycheck from a big out-of-State mail order company?

Mr. Chairman, I am proud that the Louisiana State Senate recently passed a resolution urging the U.S. Congress to protect the traditional retail industry by passing interstate sales tax legislation, and I implore the members of the subcommittee to take up the challenge. It is time to end the tax subsidization of the direct marketing industry. Allow traditional retailers and direct marketers to play by the same set of rules. Retailers are certainly up to the challenge of competing on a level playing field. In doing so, you will tear down barriers to fair competition, preserve and create jobs and provide badly needed revenues for State and local economies.

Thank you for allowing me to present my testimony today, and I will be happy to answer any questions you have. Thank you.

Chairman BILBRAY. Thank you very much.

[Mr. Maurin's statement may be found in the appendix.]

Chairman BILBRAY. Mr. Cohen.

TESTIMONY OF RUSSELL COHEN, CARLYLE & COMPANY JEWELERS, GREENSBORO, NORTH CAROLINA

Mr. COHEN. Mr. Chairman, members of the subcommittee, I am Russell Cohen, chairman and CEO of Carlyle & Company Jewelers. We operate 82 stores in 11 States, including four States that are represented by members of the subcommittee.

Seventy-two years ago, my grandfather started the business in Greensboro, North Carolina. We now operate under three names: Jewel Box, Carlyle & Company, and J.E. Caldwell & Company.

I appear today on behalf of the Jewelers of America, a retail trade association comprised of over 10,000 members representing 17,000 stores in all 50 States.

The Jewelers of America strongly support Senator Dale Bumpers' legislation, S. 1825, and we welcome this opportunity to explain why. It is based upon two strong foundations: Fairness and the vitality of local communities. This legislation, if enacted, would contribute to both of these goals in a very meaningful way.

As a matter of public policy, Congress should do all in its power to encourage local businesses, local employment opportunities and the well-being of local communities.

I would like to now illustrate a few of the jewelers' concerns.

Fine watches are a very important part of retail jewelry merchandising. The average Rolex watch sale in our business is around $4,200. One of the Nation's largest retail jewelry stores frequently takes out full-page ads in the national edition of the *New York Times* advertising many fine watch lines, including Rolex.

If a North Carolina resident orders by mail or over the phone, he or she does not pay the 6 percent North Carolina sales tax. It is a significant advantage. Even though we match the New York selling price, we lose the sale.

Under North Carolina law, a North Carolina resident is obligated to pay a use tax on out-of-State purchases. But the simple fact is enforcement of the use tax payment is ineffective. The bottom line is our firm loses a sale, North Carolina loses sales taxes that would have been collected, and the State never receives the use tax. Thus, North Carolina businesses and the State are losers.

In addition to that, if the purchase is not paid for, the New York firm or a credit card company will certainly use the North Carolina court systems to try to collect the bad debt. Also, if there is a warranty complaint, this will be brought up by—in front of the State Attorney General's office and—which will investigate the complaint. These State services are subsidized by businesses like mine, and the out-of-State companies conducting mail-order business have a free ride. To continue this policy would simply make no sense, and that is why we need S. 1825 or a bill like it to correct this inequity.

In our industry, we are especially vulnerable to mail-order sales of branded items over $500 in value. Such world-renowned items made by LaLique and Steuben come to mind as merchandise that can easily be ordered by mail or over the phone. Why would the customer choose to pay the sales tax if that customer knew the equivalent sales taxes on mail-order sales could be ignored with impunity?

Our employees have assisted customers with gift selections only to have the customer walk and order the merchandise directly from the New York headquarters of the name-brand retailer. Thus, when we lose a sale of a customer to avoid the payment of taxes, we lose and the State loses.

I have heard it said before that mail-order is used as a convenience and not as a means to save taxes. Based upon our experience in the greater Philadelphia area where our J.E. Caldwell and Company stores are centered, I can categorically say in the case of retail jewelry sales taxes do matter. On countless occasions, too many to enumerate, our Philadelphia store's clientele would do their shopping at our stores in that city and then drive to our Wilmington, Delaware, store where there is no State sales tax and do their buying.

Let us be clear, S. 1825 is not a new tax. There are currently five States in which there are no sales tax, and it is very unlikely that these States would consider a sales tax in the future if S. 1825 were enacted. Thus, this is not a new tax.

We believe S. 1825 is also being constructed to ensure there is no undue burden on business in general and small business in particular. Four provisions, especially, come to mind that demonstrate the even-handedness of this legislation:

The de minimis exemption in 3 offers a meaningful business threshold. In S. 1825 there is the option to choose a so-called "in-lieu" fee which makes a single-rate option available to every customer. Another provision minimizes paperwork by calling for quar-

terly filing. Mandatory toll-free consumer hotlines are required to be established to provide information.

As we enter the interactive television era when conventional merchandising will be turned upside down by TV shopping networks, Congress should be thinking about changing the climate to allow States to make a demand on out-of-State firms to remit a use tax on these sales. Otherwise, Congress, by its inaction, will continue the inherently unfair system that places Main Street firms at a competitive disadvantage.

It is certainly worth noting that the Home Shopping Network does collect taxes from their customers and remits the proceeds to appropriate State and local agencies. If this company can do it, so should others who meet the sales volume criteria in S. 1825.

Mr. Chairman, thank you for this opportunity, and I welcome questions.

Chairman BILBRAY. Thank you, Mr. Cohen.

[Mr. Cohen's statement may be found in the appendix.]

Chairman BILBRAY. A couple things come to my mind.

Mr. Bookwalter, you have two complaints. One is against people who actually go into San Francisco, which is close to the Reno-Tahoe area, and actually purchase goods from large retailers or wholesalers there, have it delivered to the Nevada side and don't pay the taxes.

Mr. BOOKWALTER. That is correct.

Chairman BILBRAY. And the other, of course, is the mail-order. Which is the more serious problem for your business?

Mr. BOOKWALTER. In my specific business, it is the—the border encroachment because we do much more appliance business than we do electronics. Appliances, obviously, are too heavy to mail, and that is where the big bulk of our problem is.

Chairman BILBRAY. I see. Is that true, Mr. Maurin, do you have the same problems? Or is mail-order the main problem?

Mr. MAURIN. I think it is one of the biggest problems facing the shopping center industry in general. It is primarily the mail-order and the electronic shopping.

Chairman BILBRAY. Mr. Cohen?

Mr. COHEN. I certainly agree it is much more of a problem mail-order.

I used the illustration of a customer driving over the border from Pennsylvania into Delaware just to illustrate that if someone will take that time to drive 30 or 40 miles and it is much easier to pick up a telephone or send in the mail-order, particularly in jewelry items that are very easily sent through the mail, it is a very serious problem.

Chairman BILBRAY. I had mentioned earlier that I had two letters from two different consumers. Both of these individuals, their complaints are the fact that they were told when they purchased their goods—in one case I think it was mail-order, the other was buying furniture in North Carolina, returning to their State and then several years later getting a notice from the South Carolina State that they now owed penalties, $700 in taxes on the purchase plus penalties and interest and so forth.

The internal audits from the States just do not catch enough of what you are looking at or do they? There seems to be at least some cooperation between South Carolina and North Carolina.

Mr. COHEN. In my experience, this is a very rare exception. I mean, it is highly unusual. But, again, it illustrates the customer really has no idea that there is anything such as a use tax and that they are required to pay that. Again, it illustrates that this really is not, I said before, a new tax. It is just simply a situation of wanting everyone to collect the tax that right now causes a very unlevel playing field.

Chairman BILBRAY. Is that true of all of you, that this is the exception, what we saw here today?

Mr. MAURIN. Well, I would only comment that, to maybe quote a famous Louisiana politician who served here in Congress one time, that, after accepting a contribution that was made to him that was illegal, he said it was not illegal for me to accept the contribution at the time. It was illegal for the person to give the contribution to me.

The problem that we have here is that in many of these States the consumer is required to remit the sales taxes if in fact, he would have do that. The fact is the burden falls on the consumer, not upon the seller of the merchandise. That is really where the problem is, is that the merchants are certainly not—the mail-order merchants are certainly not doing anything illegal. They have no obligation on them.

But, clearly, in many States, the tax is due in some form, but it—the burden falls upon the consumer. That system is just not working.

Chairman BILBRAY. There was an offer—as I understand, at one time there was a negotiation going on between different entities to come up with a formula for collection by all mail-order houses, and then there would be a proportional distribution, depending on the amount of business they keep in their computers, to the individual States. It is my understanding that that fell apart, not on behalf of the mail-order people but because of the State and local governments and the retail associations.

Can you give me—and bring me up to date on that, if any of you were involved in that?

Mr. BOOKWALTER. No.

Chairman BILBRAY. What do you think about that idea?

Mr. MAURIN. I would say that you still have a lag in the sense that what we are seeing in State government now is a much greater dependence upon sales taxes to pay the bills, and I think we are seeing that not only in Louisiana, which is a very high sales tax State, but other States that are going to that form of tax, California for example, away from property taxes.

To come up with a standard number is not a bad idea. I think 4 percent is too low. If you check the sales taxes in the communities across the country, I think that you will find that very much on the low end. This would certainly get the playing field a little more level but not really leveling it in communities like in Louisiana where sales taxes run typically 6 to 9 percent.

Mr. BOOKWALTER. If it has been demonstrated that a large direct merchant can collect and redistribute the taxes and it doesn't seem

to affect his ability to do business nor his competitiveness, I think that all should be able to do that, no matter what size they are.

Mr. COHEN. I add to that. Again, we operate in 11 States. We simply program our computers to compute the sales tax, remit the sales tax to each of the States where we operate. Certainly, the highly sophisticated environment that we live in today, it is not difficult at all to track the sales tax in various States—really, all 50 States.

Chairman BILBRAY. So what you are telling me is you think the proposal is not a good idea.

Mr. COHEN. I am just saying a set amount, my feeling is that the reason for that would be to make it much simpler. Our technology, vast use of computers, it is very easy to collect, first identify what the tax is by State and collect that tax.

Chairman BILBRAY. Being the devil's advocate, if I was a consumer and I was ordering out of a catalog—let's say I am not calling in where they actually compute it right there on the screen. I write a check, and I mail it in, and I have to go through these charts. Every chart says, well, in the State of Michigan, it is 7.8, the next State it is 7.9. I can see all sorts of problems.

Like I said, I am sure we will hear from that panel last, although there is only one witness on this. But it would seem like that probably is the reason.

If you call in, like you call into your store, go into your store, I can understand that you would figure it out for them. But, I am not sure the masses can compute that.

Mr. COHEN. I just submit that, again, we have to keep in mind this industry, mail-order industry, and particularly now talking about interactive buying is advancing so quickly that it will be just a matter of a couple of years before very few people even are ordering by mail. It will be all over the telephone or through television or through a PC. I think we have to really look forward over the next couple of years. Things are just changing so rapidly today that——

Chairman BILBRAY. You are saying we have to address this now.

Mr. COHEN. When you talk of those problems, you are really looking back 3, 4, 5, or 10 years, and they were certainly very real problems. But I am convinced they will disappear moving forward.

Mr. MAURIN. When you look at the Senate bill, too, they have tried to put some things in there to try not to create a paperwork nightmare for the mail-order industry, and that is certainly not the intention.

If anybody has ever shopped mail-order more than once, you realize if you call, if you have ever shopped before, they have on the computer everything in the world there is to know about you, to know what your sales tax rate is by your zip code or whatever. They are probably the most highly sophisticated, technology-wise of any business in the country right now, very sophisticated.

I guess my point is a lot is being made of figuring out what your tax rate is and what your tax rate is. The fact of the matter now, technology has taken care of that. If you are on their mailing list and you are a customer and they know your zip code, they know your tax rate. So, that is not that big of a deal.

I think the idea of having them remit to the States, i.e., at the end of a month that they send out 50 checks, if there are 50 States that they had purchases from, rather than to every little community within the State, and let the States decide how the taxes are spread, is a fair way to do it. But that is just simply, I think, an overblown problem.

Chairman BILBRAY. Thank you.

Mr. Sisisky.

Mr. SISISKY. Thank you. I thank you gentlemen for being here. Of course, mail-order is not your only problem as a retailer. I mean, you also have to worry about discount houses, things like that. Particularly in so many of the industries, particularly Mr. Cohen and Mr. Bookwalter, you have got to have value added to make people want to shop with you.

I can understand the difference. Somebody gets a camera for $1,000, saves $60 bucks. It buys a lot of film for the camera.

I do know that the direct marketing industry is very sophisticated. I think they exchange lists. Because I think I not only get one catalog from a company but two and three catalogs. It depends how my wife writes the check, with her first initial "R" or whether she puts the full name, things like that.

You are right about the zip code. That is the key to it all.

I mean, there are other problems in retail business. I have always said the only way you can stay in the retail business is the value added. You can't compete unless you do that service and convince the public that you have that service.

Mr. Maurin, you should have never asked the question how many people receive checks from a direct marketing. I got a lot of them in my area, warehouses and everything else, so I do have a lot of people in that industry. But I am concerned about it, to be very honest with you. It is a great concern to me.

Mr. Maurin, you state in your testimony that this tax avoidance has created a competitive disadvantage which has hit the mom and pop retail stores the hardest, particularly as it relates to shopping centers. I notice a lot of strip shopping centers have open stores, renting space in them.

Can you estimate how many retail stores located in your shopping centers have been forced out of business in recent years due to this problem? Not the other problems that I talked about of discount stores, mismanagement, short cash position and things like that. Really, what kind of operations were they that were being hit the hardest?

Mr. MAURIN. I think that is a fair question. I have been in the business for 20 years in the shopping center business, building, developing shopping centers and leasing to merchants. It is unbelievable what has happened over that period of time. The retailers that have been hit the hardest have been the ones that you see the most magazines coming from.

In the 40 centers, we probably had a jewelry store in every center at one time. I think I have two jewelry operations in 40 shopping centers.

Men's and ladies' ready to wear is probably the other hardest hit area where, again, the small mom and pop, men's and ladies' ready to wear has got competition on both sides.

We have sales taxes in Louisiana, very high sales tax State, very dependent. It runs as high as 9 percent in some municipalities, and I think the lowest I have seen has been 6. We have a State sales tax of 4 percent and the local and State governments added on.

So in States where there is significant sales tax, sales tax is used to pay the cost of local government, those are the ones that are hit the hardest.

But I would say the specific retailers—look at the catalogs you are receiving, men's and ladies' ready to wear. I don't think we have five independent men's and ladies' ready-to-wear stores out of the 1,000 tenants that I have in my shopping centers today. Before, that used to be one of the largest categories.

Mr. SISISKY. Is the men's catalogs—you know, I am a man. I do receive catalogs. I don't notice a proliferation. There is a great store, it sends a great catalog, from California.

Mr. MAURIN. Men's stores, in my judgment, have been hit harder than the ladies.

Mr. SISISKY. Probably because of the discount stores and the lack of men wearing suits.

Mr. MAURIN. But they have been hit harder. Those small merchants have disappeared. They are gone. I am not sure if they will ever come back.

It is not just this issue. I don't want to put it all on this.

The electronics industry is another one that has been hit particularly hard. We had all these small computer stores in our centers back in the early 1980's. We don't have a single small computer store left in any shopping center that we own or operate now simply because the catalogs, the mail-order catalogs and the books and the computer books, you can order it. It is shipped. You save the sales taxes. It is there in 2 or 3 days.

Mr. SISISKY. Of course, a lot of problems with retailers, too, is you buy something in New York. You want to ship it home. You won't have to pay taxes on it.

You deal, Mr. Cohen, in 11 States. You are required by law in those 11 States to collect taxes, am I correct?

Mr. COHEN. That is correct.

Mr. SISISKY. You have to collect in that State.

Mr. COHEN. If we ship from North Carolina to Pennsylvania, because we operate in Pennsylvania we are required to collect the tax.

Mr. SISISKY. You being the devil's advocate—and I understand your problem—you will solve one problem if the Bumpers bill would pass, but you don't solve the problem of the retailers not collecting the tax on an out-of-State sale, am I correct? There is nothing in that law that would prevent that.

In other words, in California, if somebody buys that camera for $1,000, they could just ship it across the border, and it wouldn't collect taxes. So, the State is still losing money.

Mr. BOOKWALTER. If they bought it in California physically, they are going to pay the California sales tax.

Chairman BILBRAY. I think what Mr. Sisisky is saying is this bill only addresses the mail-order part of it. The fact that somebody goes over to a wholesaler in San Francisco and orders 20 refrig-

erators and they ship them over to him, this bill does not address that problem. I think that is what the gentleman's getting at.

Mr. SISISKY. I don't think so, but, of course, I don't know how you address that problem. But I can understand the problem, and you are absolutely right. This industry is growing by leaps and bounds. For good reason.

There are a lot of reasons, and it is not just sales tax. It is convenience and other things, the fear of people, particularly among the elderly. My wife is elderly. She would kill me if she heard me say that, but she is. She is on Medicare, what the hell, you know?

Chairman BILBRAY. If this is on C-SPAN, you are in deep trouble.

Mr. SISISKY. I am telling you. But thank you for being here today.

Chairman BILBRAY. Mr. Hilliard?

Mr. HILLIARD. Thank you very much, Mr. Chairman.

I am concerned about the local counties and municipalities getting the money, also. I don't see any real problem if you are going to do it by zip codes. Even though you send one check to the State, there is no problem with listing the amount of money that each zip code is entitled to, is there?

Mr. COHEN. Not that I am aware of.

Mr. HILLIARD. All right. So, actually, we don't have a problem. I understand all of you are on board and endorse the bill. You feel that it is necessary to help not only the State collect needed revenue and the municipalities but you think it would help the small proprietorship. Is that what I am hearing?

Mr. MAURIN. It levels the playing field. That is all. There are so many things that make the playing field unlevel for small business people today.

Let's face it, that is where the majority of the new jobs are coming right now. But small retailers, we can't solve all the problems that they face, and you are correct, this is not it. We are merely saying that this is an inequity that simply must be addressed. The direct marketing industry is growing so fast, it is scary. We might as well address the issue now when it is a $234 billion industry. What happens when it becomes a trillion-dollar industry or $2 trillion industry? It is only growing.

Mr. HILLIARD. Absolutely.

I have another problem. I represent a rural area, 14 counties, a very large area geographically. Of course, we will have stores closing all along, and the population is about the same as it was a couple decades ago. Of course, this could be attributed to many things, but I am sure that this is one of the factors.

I am from a high-tax State, Alabama. We have some counties when you include the city, county, State sales taxes, where sales taxes reach 10 percent. The average is about 8½ to 9 percent. So, someone could very easily give a 10 percent discount. When you are ordering large-cost items or items that cost quite a bit, that is somewhat expensive, you can realize the savings. So, I think the bill is in order, probably overdue.

Thank you very much.

Chairman BILBRAY. Mrs. Clayton?

Mrs. CLAYTON. Mr. Chairman, I want to thank you for having the hearing and letting us discuss this issue, which is important, among others, that impact small communities, small entrepreneurs.

As I understand it, there is not a comparable bill right now in the House side, but you said there is support for this, I guess, for the Senate bill that is on the Senate side. I want to commend the Chairman for allowing us to have this discussion even though there is not a comparable bill here.

I also want to acknowledge, Mr. Chairman, that Mr. Cohen, who is here from North Carolina, has a number of stores in my district so I, in my self-interest, do want to make sure he is prosperous and employ a lot of people there.

However, the larger issue of collecting taxes, is there no way of enforcing this without the bill now? If there is a legal obligation to pay the taxes, they are not new taxes, we are talking about the issue of enforcement, right?

Mr. COHEN. Right. That would involve, as I understand it, auditing companies in each State and—in order to do it fairly and accurately, auditing all companies in each State and then going to the individual consumer and demanding that they pay use tax. Because, at the moment, it is really up to the individual consumer to pay that tax. It is not being paid.

Mrs. CLAYTON. So help me understand this. Does the Senate bill now change the obligation from the consumer now to the seller, retailer?

Mr. COHEN. To collect the tax.

Mrs. CLAYTON. OK.

Mr. MAURIN. The direct marketer assumes the same responsibility that the retailer on premise or that sells from his place of business has to assume now. So, it really equalizes a law. That burden is now on that retailer that is selling out of that store to remit those taxes. It will put the same obligation on the direct marketer.

Mrs. CLAYTON. Thank you.

Mr. SISISKY. If the lady would yield.

Mrs. CLAYTON. Yes.

Mr. SISISKY. I think in that Senate bill there is also something. The direct marketer who does $3 million sales or less will not be obligated to because of the cost.

Mrs. CLAYTON. To make the reimbursement?

Mr. SISISKY. Right.

Mrs. CLAYTON. So if the company——

Mr. SISISKY. The smaller company.

Mrs. CLAYTON [continuing]. the smaller direct business owner, he doesn't have to—he is exempted from this.

Mr. SISISKY. Right.

Mrs. CLAYTON. Three million. Is that a problem with you all? You don't see that as a problem? Is that problematic?

Mr. MAURIN. I think what the Senate bill is trying to do is address the question of how to make it work, and this is really it. But at $234 billion, you have got to realize that the bulk of these sales, probably 98 percent, is coming from those that are over $3 million.

So I guess in passing it and putting that burden upon the direct marketers to have to remit those taxes and to be set up and do that

we don't want to put a lot of little people out of business by doing it, and I guess maybe this is a transition method or whatever. But it is just to try to deal with some of the criticism associated with putting an undue burden on the direct marketer and making him do something that he can't, that is very difficult for him to do.

Mrs. CLAYTON. Mr. Chairman, is there some movement on the House on your part? I want to thank you for having the hearing, but I was just wondering if—is this precursory to something.

Chairman BILBRAY. Well, actually, what we are doing now is looking at the issue because what we want to do is we have the 104th Congress coming up. If we address this issue in the 104th, we have a record established now, and the subcommittee has looked at it.

Mrs. CLAYTON. Thank you, Mr. Chairman.

Chairman BILBRAY. Mr. Hilliard, you had another question.

Mr. HILLIARD. Yes. Just a couple other questions.

I understand each one of you has given us information about what you consider to be the good points of the bill and the concept. What are some of the liabilities? Mr. Cohen?

Mr. COHEN. I really—I can't think of any.

Mr. HILLIARD. Other members of the panel?

Mr. MAURIN. I can't think of any, either. I think even some folks from the direct marketing industry have been quoted saying that this would not really, in their mind, be detrimental to them. I think it is a win-win situation.

Mr. HILLIARD. We were trying to ascertain up here also what would the liabilities be.

Mr. SISISKY. If the gentleman would yield.

Mr. HILLIARD. Yes.

Mr. SISISKY. I tell you one thing. If the larger companies that are the size of that industry would float a month of the money in sales tax, that would be tremendous. I mean, 6 or 7 percent on the sales, they would float that, pretty nice.

Chairman BILBRAY. You know who the richest businessman on this panel is that understood that real quick.

Mrs. CLAYTON. These two here in the middle.

Mr. HILLIARD. Mr. Chairman.

Chairman BILBRAY. Yes.

Mr. HILLIARD. Without objection—if there were no objections, I have a statement that I would like to have entered into the record.

Chairman BILBRAY. Without objection, is put in the record.

Mr. HILLIARD. Thank you.

[Mr. Hilliard's statement may be found in the appendix.]

Chairman BILBRAY. I would like to thank the panel for coming, and I think the information you gave is very informative. We will certainly have a record here to establish for the beginning of the next Congress. Thank you.

At this time, I would like to call panel number two: Dr. James McNeer, mayor of the city of Colonial Heights, Virginia; Mr. Raymond Byers, board president, Novi—N-O-V-I—Community School, Novi, Michigan.

Chairman BILBRAY. We will start with Mr. McNeer.

TESTIMONY OF JAMES B. MCNEER, MAYOR, CITY OF COLONIAL HEIGHTS, COLONIAL HEIGHTS, VIRGINIA

Mr. McNEER. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I am James B. McNeer, mayor of the city of Colonial Heights, Virginia, and also provost and dean of Faculty at Richard Bland College, a 2-year college branch of the College of William and Mary.

However, I appear before this subcommittee today on behalf of both the National League of Cities and the U.S. Conference of Mayors. I appreciate the opportunity to express our strong support for S. 1825, the Tax Fairness for Main Street Business Act, which was introduced by Senator Dale Bumpers in late January.

The issue surrounding the collection of sales tax by out-of-State firms is not new to local governments. It was back in 1988 that a coalition of State and local governments developed a consensus approach to the collection of out-of-State sales tax that accomplished two critical objectives.

First, the consensus approach was designed to ensure that both State and local governments share equitably in the revenues generated by the collection of sales tax.

Second, the consensus approach was designed to simplify the collection of sales tax for direct marketing companies by establishing an in-lieu fee in States where local sales tax rates are not uniform.

It is with great satisfaction that we now find the consensus approach developed by the State and local government coalition included in S. 1825. We are also pleased to join in the reinvigorated coalition effort with the local retail community in supporting this new legislation.

Mr. Chairman, I would like to begin by making several important points. First, S. 1825 is—as has already been stated, does not impose a new tax. In fact, consumers are currently required by law to pay sales taxes in their home jurisdiction when they purchase goods from out-of-State retailers. However, many do not, and out-of-State retailers are not presently required to collect and remit such sales taxes.

What we are supporting in S. 1825 is simply correcting this Federal loophole which improperly immunizes direct marketing firms from their responsibility to collect and remit existing sales taxes.

Second, in the current era of high technology and information superhighway, direct marketing firms are now more than ever capable of collecting and remitting State and local sales taxes with minimum expense.

Third, S. 1825 further minimizes the effort and expense for direct marketing firms by requiring a single tax collection rate for each State, either unified or in lieu, for the purpose of this act and exempting smaller firms from the requirement to collect the tax.

It has already been mentioned, the $3 million figure. Potential revenue benefits from this legislation for State and local governments have been well documented.

Attached to my written testimony is an estimated revenue chart for 1994 prepared by the Advisory Council for Intergovernmental Relations which I believe speaks for itself. As you can see, the State of Virginia would have gained $59.9 million in 1994 from the collection of State and local sales taxes.

Of that total, the city estimates that Colonial Heights—and our population is about 16,000 people—would have gained $100,000 in fiscal year 1994. Our total budget was approximately $22.6 million, of which $3.7 million came from sales tax revenues.

We have 1,169 businesses within the city. Approximately 600 of those had been placed—put in place since the opening of the shopping mall and the peripheral development in 1989. The estimated 100,000 would represent a 2.7 percent increase in local option sales tax revenues raised for our community.

In addition to the direct revenue benefit for State and local governments, the Tax Fairness for Main Street Business Act would help level the playing field, so to speak, for small businesses. The economic realities of infrastructure deficits and crime have made it difficult for smaller businesses to survive, let alone grow in an increasing number of cities and towns. We have witnessed in the city of Colonial Heights and other neighboring cities the closing of many of our small businesses and suffered the ensuing loss of retail jobs and overall decline in economic conditions.

These problems are being addressed in a cooperative manner by all levels of government—local, State and Federal. However, we find it absolutely unforgivable that, in addition to the impediments facing small businesses, which we are working together to address, our local retail communities are placed at a competitive disadvantage vis-a-vis direct marketing firms which have the advantage not only of the existing and ever-improving systems of mass communication and advertising but are also free from the requirement to collect State and local sales taxes.

The competitive advantage enjoyed by direct marketing firms is not limited to the protection from the collection of State and local sales taxes. Direct marketing firms are dependent upon the services and infrastructure provided by State and local governments, and this also is one of my major concerns. Our roads are used in product delivery. Our police protect product delivery. Our courts handle cases of nonpayment and product theft.

To be more specific, let's look at the issue of landfill disposal. We have spent over the last 8 years $1.6 million in closing out a landfill. Our cost of sending solid waste to jurisdictions outside our locality has gone within the last 2 years from $8 a ton to $34 a ton. So, this is a substantial increase in our costs. As a result, local governments incur significant costs to cover the expense of disposal or recycling of these catalogs. However, local governments by their very nature must turn to the public to pay for these increased costs.

In present times, it has increasingly become the local retail community which has been forced to charge higher sales taxes and pay higher income taxes and user fees to cover these infrastructure costs. Therefore, the collection of sales tax from direct marketing firms will not only increase revenues for State and local governments but also help spread the burden of waste disposal and other public infrastructure improvements presently borne in large measure by the local retail community.

Mr. Chairman, America's cities and towns are at a pivotal juncture in their economic history. As we are all aware, the new economic revolution is fueled by smaller businesses that are adaptable

and agile. The large corporations which provided so many of the job opportunities for our residents are downsizing, resulting in a period of major job loss which continues today. Ensuring economic opportunities and a level playing field for small, commercial enterprise is an important step for our economy.

I was reading a banking journal the other day and ran across this statement that I would like to add that said that small businesses are the fuel that keep the job express running, and this country cannot afford to let the tank run dry. This was a NationsBank publication regarding banking, industry and small business.

Unfortunately, the smaller businesses which now play such a large role in sustaining our economy and providing for economic recovery have found it increasingly difficult to survive or expand in many cities. This basic problem found expression in the Employment Zone and Enterprise Community Program enacted into law in 1993. The enactment of the EZ/EC Program resulted from general agreement on the economic and social need to provide opportunities for people to work in their communities, to become owners of small businesses in those communities and to become leaders in their community.

As both the administration and many Members of Congress expressed, the underpinning intent of the program is to both attract new small- to medium-sized businesses into distressed urban and rural cities and towns and to provide incentives to existing small businesses to expand their activities and thus provide for new job opportunities.

The National League of Cities and the U.S. Conference of Mayors actively supported the creation of this demonstration program and agreed with the need to find innovative new weapons in the battle against decay and unemployment in our cities. In our opinion, the Tax Fairness for Main Street Business Act is a necessary tool which must also be employed to not only assist the very limited number of communities which are eventually designated as EZ's or EC's but also the hundreds of communities which will apply but may not be designated.

All of these areas share the common need to encourage the creation and growth of small businesses, a need which will not be satisfied by any Federal economic development program alone.

It is for these reasons that the National League of Cities and the U.S. Conference of Mayors strongly support S. 1825 and urges every member of this subcommittee to be an original sponsor of a House companion bill which should be introduced early in the 104th Congress. Both houses of Congress must act expeditiously to reconcile this problem.

Thank you, Mr. Chairman, for both holding the hearing on this important issue and for the opportunity to testify here today. At the appropriate time, I would be happy to answer any questions.

Chairman BILBRAY. Thank you very much, Mr. McNeer.

[Mr. McNeer's statement may be found in the appendix.]

Chairman BILBRAY. Mr. Byers.

TESTIMONY OF RAYMOND BYERS, BOARD PRESIDENT, NOVI COMMUNITY SCHOOL, NOVI, MICHIGAN

Mr. BYERS. Mr. Chairman, members of the subcommittee, thank you.

My name is Ray Byers, and I am pleased to be here today and appreciate the opportunity to testify about the need for legislation that would close a gaping loophole in our tax laws and prove to be of enormous benefit to our Nation's school children.

I have been an elected member of the Novi Community School's Board of Education for 9 years. I am here today on behalf of the Novi—of the National School Board Association, the Michigan Association of School Boards, the Novi Community School Board and over 95,000 local school board members responsible for governing local school directs across the Nation.

This statement has also been endorsed by the National Education Association, which represents over 2.2 million public school teachers, educational support personnel and higher education faculty, as well as the American Association of School Administrators.

I am here to discuss an inequity in our tax laws. It is one that can easily be remedied and one that, once corrected, will send an estimated $3.9 billion into the State and local funding stream. The relative health of the revenue stream at the State and local level has a considerable impact on the ability of public schools to deliver quality education.

Public school districts obtain over 90 percent of their budget from State and local governments. Clearly, an additional $3.9 billion in tax revenue collected at the State and local level will have a large impact on the public school system.

In Michigan, we have just enacted a dramatic shift away from using property tax to using the sales tax for funding our public schools.

There are three levels of impact that will be felt by the public school systems if the mail-order sales tax collection bill becomes law. First, each school district in the country stands to benefit from the boost to its fiscal health of State and local governments. In recent years, we have seen State and local governments struggle to maintain fiscal strength. Shrinking budgets and diminishing property values have meant very hard choices.

State and local policymakers recognize that their decisions literally determine what resources will or won't come into our school children's hands. Do they fund a hospital wing or do they develop a high school science program? These are real problems.

A recent study analyzing school facilities found that fully 74 percent of our Nation's schools need to be replaced or extensively modernized in order to provide appropriate learning environments. As lawmakers, you understand all too well these dilemmas and, as a school board member, I am on the front lines of this dilemma.

The $3.9 billion that the collection of mail-order sales taxes would bring to State and local governments will help State and local governments out of a fiscal bind. Many States will have a little more freedom in making tough choices and will be able to more fully invest in the future of our school children.

Schools will also benefit from putting equity back into local businesses. Local small businesses no longer will be in competition with

out-of-State mail-order Goliaths with a large tax break. They will have a fighting chance to prosper, and their prosperity will be felt in the community, in the property taxes, in the tax base and, therefore, in the local schools.

There is a second level of impact on schools that the collection of mail-order sales taxes will bring. There are several States, including my home State of Michigan, in which education stands to get a direct boost from this bill. Those States have decided to dedicate to education all or most of the new revenues raised from collecting mail-order taxes after this Federal loophole is closed.

In Michigan, for instance, 60 percent of the first 4 percent and 100 percent of the next 2 percent in mail-order sales taxes will go directly to the public school system. The Michigan School Board Association estimates that once the Tax Fairness Act goes into effect, 60 million new dollars will flow into the Michigan school system. The only impediment to bringing these much-needed funds directly to the schools would be inaction by Congress.

Finally, there are at least 10 States that have earmarked all or a portion of their general sales tax revenue for education. In those States, of which Michigan is one, the taxes collected as a result of mail-order sales tax legislation will have a direct benefit to the public schools. Those new taxes will increase the pot of money that already has been dedicated to education, and it is worth noting that while earmarking a variety of revenue streams is a widespread phenomena, the sales tax has been by far the most popular revenue source to earmark for education. That makes legislation like this even more critical to schools.

Several States have particularly high reliance on sales taxes to fund their educational programs. In South Dakota, 56.8 percent of their local contribution to the education budget comes from local sales taxes. In Louisiana, the sales tax provides 55.1 percent of the State's share. In my home State, Michigan, 37 percent of school funding is from sales tax revenues. While not as large as the other States, it is the highest single source of revenue for the schools in Michigan.

In conclusion, Mr. Chairman, the National School Board Association, the Michigan Association of School Boards, along with the National Education Association, the American Association of School Administrators and, most importantly, my local school community urge the subcommittee to support public education by introducing and passing legislation that allows States to collect mail-order sales taxes. The legislation is of paramount importance the our Nation's school children and will provide critical dollars for State and local governments to reinvest in education.

I want to thank you again for the opportunity to speak before you today.

Chairman BILBRAY. Thank you, Mr. Byers.

[Mr. Byers' statement may be found in the appendix.]

Chairman BILBRAY. Mr. Sisisky.

Mr. SISISKY. Thank you and welcome to both of you gentlemen, particularly Mayor McNeer. It is always good to see you.

I think you state in your testimony that the city of Colonial Heights, which is not a very large community, would gain approximately $100,000 a year in additional revenue if the legislation was

passed. Can you describe what kind of programs or services the city would fund from this additional revenue?

Mr. McNEER. Well, there are several options that we might have. One would be to develop economic development procedures that would enable us to attract small business and to provide that information to potential developers coming into the community.

It would serve in our public safety program through our police department. It would hire one additional police officer and pay the benefits plus a vehicle for he or she, a fireman or a paramedic.

It would provide water line replacement in some of the areas of the city adjacent to our small businesses where we are trying to move from 2- and 4-inch, 6-inch water lines to 12- and 16-inch water lines.

It would do any number of things that would enhance the opportunity for small business to—either to come into the community or to assist us in retaining that business.

Mr. SISISKY. I hadn't even thought of the waste stream, which must be huge around the country. Didn't even dawn on me. You ought to be glad I am not living in Colonial Heights. I live across the river.

Mr. McNEER. If it were, we would have it come to your home in a recycling program and pick up your recyclables. But it is a very expensive operation and, as I mentioned, it has gone from—disposable to private landfills outside the city have gone from $8 a ton to $34 a ton within a couple of years, and I know some—in some areas in metropolitan areas that it has over $100 a ton for waste disposal if they can find a place to take it.

If I might follow up on one statement. You asked the previous panel about a situation where a retailer who delivers products into other States, whether that was applicable under this Bumpers bill. It is applicable to the extent that the retailer in California solicits in Nevada in any fashion, whether it be newspaper, TV, radio, magazines, or whatever. They still would be subject to completing the appropriate forms and filing and collecting that tax. So,——

Mr. SISISKY. Every retailer would have to do that?

Mr. McNEER. If that retailer does business in that particular State. As I mentioned, he mentioned the refrigerators being purchased in California. That if that retailer in California solicits in Nevada for refrigerator sales and we have them at "X" price, then that is subject to the—to law, as I understand it.

Mr. SISISKY. Of course, the only problem with that is if you buy the *New York Times*, in jewelry, especially, you are soliciting all over the country.

Mr. McNEER. But it does, in part, address that.

Mr. SISISKY. Just as a matter of record, I know, Mr. Byers, you talked about education. Since Dr. McNeer is also an educator and, of course, he is local from my community, we are having problems in the State budget now as pertains to higher education and elementary, secondary education, too. Can you describe what benefits the additional revenues generated by this program would do to education?

Mr. McNEER. Yes, I can. I would say I served two terms on our local school board prior to going on council. So, I would echo everything he said in terms of aid to the local schools.

In our higher education community, with 15 public institutions and 23 community colleges in Virginia, we are downsizing or restructuring or cutting or whatever term one wants to give to it. We have been asked this week, in fact,—effective July 1, 1995—to develop scenarios for 2, 4 and 6 percent additional cuts to the higher education budget.

This would bring $60 million into the Commonwealth of Virginia that would address many of the needs, whether it be highways, whether it be the somewhat controversial no-parole issue that is—the general assembly is meeting on and having a public hearing on today in Richmond or whether it would mean mental health or aid to local governments in effect, to local school systems or to higher education. That would be an additional revenue source that could be spread to the field of education as well as many of these others.

So I think that at a time when we are cutting back and having to put money into other areas this is a critical juncture at which we have now arrived, and I think it would be very much an advantage. It would enable us to hire some additional faculty, to do some renovation of old facilities, to be innovative and offer computer programs and courses that this next generation of small business people are going the need.

Mr. SISISKY. You didn't say what I wanted you to say, that you would lower tuitions. Or did you?

Mr. MCNEER. I try to be as honest as I can, and I don't know that I would ever be able to offer that.

Chairman BILBRAY. You are not under oath, you understand.

Mr. SISISKY. I am speaking in political terms, too.

Mr. Chairman, I thank these gentlemen for their testimony.

I apologize for leaving so soon. I really would like to hear Mr. Levering. I read part of his testimony. He raised some issues that I would like to get to, but I have an appointment. If I can get back, I will certainly try.

Thank you both very much.

Chairman BILBRAY. Thank you Mr. Sisisky.

Mr. Hilliard.

Mr. HILLIARD. Mr. Chairman, I don't have very much, but I just want to say that some time ago, about 3 years ago, I chaired on the State level the committee to handle this type of problem, Commerce, Transportation and Utility, and we had a similar hearing.

I never heard about the waste problem, but I recall when I was on my way to Congress about 40 years ago—well, about 35 years ago, I worked in the post office, and we used to hate the quarter changes because there were new catalogs coming out, and they were very heavy. I realize now that it is really a waste problem. One of the things you can do with the additional revenue is help solve or help pay the cost of solving your waste problem with those catalogs.

Mr. MCNEER. We started last September a recycling program in which we take all of the paper—any kind of newspaper, newsprint magazine, junk mail and so forth and recycle it and have it at curbside within the community. Of course, it is costly, but it is less costly than paying the $34 a ton to dispose of it somewhere.

Mr. HILLIARD. Thank you.

Chairman BILBRAY. I have a question, Mr. McNeer, on the figure what each State gets, that is based on their particular sales tax, and I heard like Louisiana has different sales taxes at every jurisdiction. So, this is a rough estimate, I presume.

Mr. MCNEER. Yes, sir. Ours in Virginia is 4 percent.

Chairman BILBRAY. All right. So, the 4 percent compromise that has been talked about before would not be bad for Virginia. But a State that had a 10 percent sales tax would not like it too well.

Mr. MCNEER. It would not be good for them.

Chairman BILBRAY. I was on the Nevada Taxation Committee, and we changed our laws to go more of a basis on the sales taxes, too. I opposed that because the property tax is a stable tax where the property tax fluctuates with the economy.

When we hit that recession in the late 1980's, I will tell you the revenues to the State just fell right through the floor. Hopefully, Michigan won't have to go through the same sort of crisis that we did with reducing school budgets and university budgets and so forth.

Mr. BYERS. Thank you, Mr. Chairman. Unfortunately, our legislature didn't have that kind of vision and have put no provision in. In fact, all local funding has now been eliminated, and all of our money now comes from the State.

Chairman BILBRAY. Our legislature did not also have the same wisdom. I was a kind of a lone voice in the wilderness crying out to stabilize our school system with the property tax, not the sales tax, but it didn't go over then. I guess it didn't go over in Michigan, either.

Mr. Hilliard, do you have any other questions?

Mr. HILLIARD. All right. I did have a question, and it was pertaining to something that you mentioned a minute ago. Why do you feel that it is necessary to have a compromise at 4 percent? Is it because that is the way it is in the bill? I mean, is there some rational reason?

Mr. MCNEER. No. I don't necessarily think that it ought to be compromised at 4 percent. I just said that that was our rate in Virginia.

But I do think that whether it is necessary in order to get the legislation passed to reach some consensus and some compromise, then I would certainly be willing to go along with that. But I do not think that it would be a problem to collect the taxes at the rate that they are imposed within the 50 States, as has been pointed out very well through the electronic means. I don't think any State ought to be penalized because of it.

But if it was absolutely necessary in order to compromise at some point in order to generate favorable—favor for the legislation, then OK. But I just strongly believe that we need to do everything we can to assist local business and to help the localities. That is the end to which we are working.

Mr. HILLIARD. In Alabama, we have the lowest property taxes in the country. One of the reasons why is because we have very large sales taxes, percentagewise. And 4 percent is the amount that goes to the State. The other 4 percent or 5 percent or 6 percent, whatever the case may be, is divided between the counties and the cities.

So if you go with 4 percent in the bill, it cuts out the cities, it cuts out the counties, and they also have problems with schools. They have problems with landfill. So, you really don't solve the problem by compromising.

Mr. McNeer. I would see no problem for the collection of 8 or 9 percent, which would be applicable to Alabama. So, I would certainly not oppose that.

Chairman Bilbray. I think, in clarification to the gentleman from Alabama, what happened was that, as you heard from the gentleman from Louisiana, you don't only have a State tax number, you have a county and sometimes municipal level. So, if you have somebody calling in on a telephone and they have a computer that can figure out your zip code and what your tax is, that is fine. But some mail orders are done by people filling out a sheet and sending in a check and having it come back.

I could just see if you live in the city of Clinton in East Feliciana Parish, your rate is 6.78. But if you live in the County or the Parish of East Feliciana but not in the city, it is 6.0. If you live in Baton Rouge Parish, it is 7.4. I can just see the people going crazy.

So I think that is why they were trying to come up with a formula, a flat rate, and maybe they could come up with a flat rate for each State rather than each entity because of some of the problems.

Mr. Portman.

Mr. Portman. Thank you, Mr. Chairman. Thank you for giving me a chance to ask a question, though I missed your testimony, which I apologize for.

I guess my question really builds on the question that was just asked on is this viable, how administratively do we handle the many thousands—I don't know if it is 4,000 or 5,000 different tax rates that would apply across the country, including at the municipal level and State level.

I guess you answered that question in a sense by saying the compromise might be to have a flat rate 4 percent or perhaps the rate, as the Chairman suggests, by State.

What is the history of the compromise that was almost worked out recently under—by the revenue commissioners? Where were they headed and why didn't that work? I don't know if, Dr. McNeer, if you are familiar with that or Mr. Byers. But if you could address that, I appreciate it.

Mr. McNeer. I am not totally familiar with that other than the fact that I know there were differing rates and differing constituencies trying to get their views across, and it was felt like that either of these two options that you mentioned, whether it be a flat rate per State or whether it be applicable to the rate within each locality. But I do not know the history of that. I just know that we are very much in need of addressing this issue, and sometimes compromise is necessary in order to come up with something that is viable.

Mr. Portman. Mr. Byers?

Mr. Byers. I am not familiar with it other than if I look at some of the various tax rates—I look at Michigan where we are now at a 6 percent sales tax and over 85 percent of the sales tax flows directly to education. I, certainly, as one local school board member,

would be very dissatisfied with receiving only a percentage of 4 percent. I would much rather receive 80 percent of 6 percent.

In Michigan, we are looking at $60 million of new money that we don't have now. Given our new tax base that we are working in, that is significant to education and our young people.

We have a terrific infrastructure problem in Michigan and across the country that somebody's going to have to address in one form or another. I will use Detroit as an example. Detroit is presently asking the local constituents for $1.5 billion to rebuild the infrastructure schools in the city of Detroit. That is a phenomenal amount of money simply to bring the schools up to a standard of safety.

I know in the District here you have the same problem with buildings that don't reach safe levels for young people to be in and there is no money. Part of that money is available through this legislation.

Mr. PORTMAN. All right. Thank you, Mr. Chairman.

Mr. MCNEER. The bill does have a one-rate-per-State provision so that could be, I think, worked out without great difficulty so that it would not be a major burden to the direct marketers who would have to submit that.

Chairman BILBRAY. Thank you, Mr. McNeer, Mr. Byers. Your testimony is appreciated and will be part of our record. We will go over it thoroughly. Thank you.

Mr. BYERS. Thank you very much.

Chairman BILBRAY. I would like to call the last witness at this time, Mr. Bob Levering, a senior vice president, Direct Marketing Association.

You are on the hot seat, Mr. Levering. Everybody has testified the other way now.

TESTIMONY OF BOB LEVERING, SENIOR VICE PRESIDENT, DIRECT MARKETING ASSOCIATION

Mr. LEVERING. That is fine. That is OK. Mr. Chairman, thank you, members of the subcommittee.

I have been with the Direct Marketing Association for 9 years. Seven of those years I spent dealing with this very issue because of its importance to our membership, and that included the last congressional struggle and the Supreme Court case in 1992.

You have been asked by the States to share some of your commerce power with them, and I see it as our role to help you understand the full consequences of doing that so that you can exercise your constitutional responsibility to protect the national marketplace.

DMA—by the way, I am going to try to respond to the issues raised, and I am not going to, obviously, read my testimony or even try to summarize it so I would ask that be included in the record.

Chairman BILBRAY. We will give you extended time to answer because you have had what, six, five panelists that have come out on the other side. So, certainly we have to give you a little more time to respond.

Mr. LEVERING. I thank you, Mr. Chairman.

I have tried to keep track of the major points raised. First, let me say that our association represents over 3,000 corporate domes-

tic members and some other foreign members, as well, and 80 percent of those members are small businesses. 100 percent of them used to be small businesses, and they just grew. Part of the problem with this bill is that it prevents the growth of direct marketing businesses for those it doesn't affect directly.

We have heard two rationales for this legislation. One is tax revenue. I can understand any governmental employees or others dependent upon Government funds being in favor of increased tax revenue, particularly as in this case where the tax is technically already on the books and if this legislation passes they would get the additional revenue and Congress would take the heat for it.

So this is actually a politician's dream from that point of view.

But I would ask that those who look at this as a revenue source keep in mind the fact that this is a very small amount of revenue. It is a lot less than even the $1.4 billion that our studies showed. Because that assumes every penny of tax would be collected at no cost to the Government, having no decrease in sales, having no tax deductible costs for the businesses. In fact, net-net, you are looking at less than half of that. That doesn't count even the hard-to-measure intangible cost to the economy and to the American society.

We are very proud of our industry, the service that we perform for 100 million American consumers every year who shop by mail or by phone and who depend upon our industry to bring the wealth of the American marketplace to their doorstep. Many of them are handicapped, elderly or rural consumers that do not have ready access to the kinds of offerings that are in large shopping malls and stores in downtown big cities. So, our service is to all of America. As a matter of fact, so are our businesses.

We are in—you may not know, we have a very low-profile industry so far. You may not know how many jobs are supported by direct marketing in your district. But Nationwide, it is 5 to 6 million jobs—5 to 6 million jobs in direct marketing.

That is not just the catalogers and the other direct response marketers. That is also printers. It is the list brokers. This really—most direct marketing businesses are really an alliance of small businesses. You have the family business that really holds it all together. Then you have the creative that is hired on the outside. That is usually a small firm, a list broker, a merge-purge operation, a printer, transportation. Transportation is big business. Everything else can be small business.

We pay an awful lot of taxes ourselves, and, of course, UPS and the other carriers pay the road taxes in every State that they go to. The printers pay their taxes. The industry is paying taxes. So, any revenue that is gained, you ought to offset by the damage you are doing to the economy, the damage you are doing to these sales.

By the way, these are incremental sales. It is a misrepresentation to think that direct marketing interacts with our retail brethren on a strictly competitive basis. We go head to head a lot of times, but in 50 percent of the time we have discovered and adjusted to this that actually we are provoking new economic activity by bringing products to the attention of consumers that they wouldn't ordinarily see.

In addition to that, we sometimes provoke economic activity with regard to products that consumers can buy in retail stores and they

do buy. That is why Brookstone and William Sonoma and on and on, Sharper Image, have opened up stores. They found out that their catalogs were driving people into other people's stores and so they decided they would want to capture that business, as well.

So our relationship with fixed-location retailers is sometimes a synergy, sometimes competition and sometimes totally different. We are new markets and new products and new opportunities, new conveniences.

Those sales would not take place but for direct marketing. A lot of those sales would be lost if the damage is done to our industry as described in my testimony.

The other reason presented for this legislation is a level playing field. Again, I think there is a mischaracterization. True, it is a shame when someone orders through the mail an expensive item and then has a warranty problem and goes to a local retailer and they take care of it. That is a shame. That is an outrage. It has nothing to do with tax legislation or this bill.

The border sales issue may be a problem, but, again, at best, you can say that this particular piece of legislation is ill-suited to cover the border sale operation. Some are covered; some are not.

As a matter of fact, when you try to do that, you cover a lot of tourist sales and you have every retailer in the country having to register. So, it is difficult to go after border sales with this kind of legislation. Worse, it does cover tens of thousands of merchants that are mail-order merchants who are not part of any problem.

So, when we talk about the jewelry industry, I know for a fact that the jewelry is not even on our radar screen. It is less than 1 percent of what we consider direct marketing.

We have heard from a couple other industries, large appliances, that really have nothing to do with our industry. Border sales may be a problem, but that is a different issue, a different industry.

We also see here our industry described as a $234 billion industry. Well, that is a good figure. We use that figure. But we use it knowing that what we are talking about is the direct response advertising medium. Those are people who use the services of direct marketing suppliers. That has nothing to do with taxable retail sales.

Over 50 percent of that $234 billion is political and charitable fund raising activities, not taxable. Another large chunk are financial services and insurance sales, cable TV. There is a whole—you get down to about $80 to $90 billion of taxable product sales, over 50 percent of that is already subject to a collection responsibility, and presumably the tax is being collected. That is because it is business-to-business sales to large businesses that are direct pay.

A lot of small manufacturers sell to General Motors, GE, et cetera. That tax is not being collected by the small manufacturers. They would go crazy with the paperwork. But it is directly paid by the large buyers.

So who would be covered by this? Well, our membership is only 3,000, but here, just for the catalog industry, I have a book that is supposed to be complete. It is about 10,000 catalogers. Now it is true that the bill is—as written, would exempt about 8,000 of these, but that does leave 2,000 that are directly covered and another 8,000 with a growth ceiling. Because you can't grow past the

threshold, begin collecting these taxes and expect to survive at that level.

In addition to these folks that are covered, the catalog industry, we have the rest of the direct marketing industry and those that are not even considered direct marketers.

National marketers, many of whom are members of the National Association of Manufacturers that wrote a brief against this issue in the Quill case—that is the Supreme Court case. They sponsored a brief that said, look, our 15,000 members are mostly small businesses, small manufacturers selling to larger enterprise all around the country, hundreds of thousands of customers. If every time we sell to them we have to get an exemption certificate or collect a tax or get a direct pay certificate back from them to justify under audit that we have fulfilled our obligation, then that paperwork burden will put us under.

So this is a concern not just to direct marketers but to all national marketers. That would include publishers, magazine publishers, book publishers, universities, university presses, et cetera. There are a lot of industries that are not within the narrow target scope of the proponents of this legislation.

But when they pick up the weapon of Federal legislation, they are not picking up a rifle to shoot at the target. They are picking up a shotgun. This legislation would hit lots of unintended targets, and that is one of the consequences that I think you should be aware of.

Another thing is that it has been characterized as not a new tax. Well, that is form over function. It is fine for the proponents to say, well, this is not a new tax because, technically, it is already on their books. But let me tell you, for consumers and for the businesses that would have to collect, this is a new tax. These are new obligations.

Let's see what the effects would be. First, let's look at businesses. Retailers say all we want to do is play by the same rules. Well, that—they may just not have looked at this carefully from a mail-order perspective.

Mr. Chairman, I appreciate the fact that you do have an understanding of the problems related to check payers. They said check payers would disappear 15 years ago.

I remember when I was in the consumer movement they said, oh, that's a thing of the past. We are on our way to an automated society with credit cards, et cetera.

It really hasn't happened. Thirty some percent of mail-order customers—and that is about 30 million customers a year—pay by check. Maybe some of you know them, but others of us pay by credit card all the time. It is hard for us to imagine that people do this all the time.

There are some companies where 85 percent of their business—85 percent of their customers pay by check. They are a $130 million a year business.

So it is not just the small businesses that would be burdened by this. In addition, the 6,000 rates are a big problem. It is not just a matter of computer programming.

Yes, there are programs out there that, with 97½ percent accuracy by zip codes, can get you the right tax if they call in by phone and if you can afford the program.

There are a lot of companies that this $12,000 to $15,000 program—which, by the way, has to be updated monthly so you have another $10,000 a year in fees just to the company that provides the software. Because sales and use tax laws in the States change hundreds of times every month, and you have to be up to date in order to be in compliance with the law.

So we have small companies having to purchase the software, install it, have a programmer, have somebody to actually follow this and then to pay the update fees. That is just for the tax rates. It has nothing to do with the exemption schedules and the definitions which are different from State to State.

I don't think I will take time here, but if you have any questions on the problems of selling food through the mail with the various rules or clothing or computer chips, there are 15 different rules for one little 15-cent computer chip—service contracts, shipping and handling all treated differently by the States. It is a big problem.

All right, what about check-paying customers? Thirty percent of your business. Even for L.L. Bean, it is 18 to 20 percent of the business is in checks coming in.

What if there is an error, there is an underpayment? Is it worth it to go chase it and bother your customer? Usually not. That is something you eat. If you eat 100 percent of the tax every time, even if it is only 10 percent of your business, that is a lot of cost, and that is a cost that a retail store would not have to bear.

The analogy, I guess, is if a retail store had to charge a different tax, depending upon where their customer lived, every street has a different tax. Let's say there are 6,000 streets in a town, and there are 46 different districts with different taxable entities, and 30 percent of their customers, they are not even allowed to help them at the cash register with a tax.

You go over there, figure out your own tax, write me a check and hand it to me. I either have to accept it and let you out of the store and go chase you later if I don't get the right amount or I have to just forget it and tell you to leave the store.

A mail-order merchant has the choice of accepting the check or rejecting it. There are no other rational options. Even just writing to the customer to ask them costs more than the average tax. The average order is still less than $100, and the average tax is not worth one communication to the customer. So, that is a cost that would have to be borne by our industry and is not the same as for retailers.

People get lulled into believing that because the tax is the same that the tax collecting burden is the same. It is not the same. For mail-order, it is different, and it is much worse.

There is a study that the Touche Ross accounting firm did for our industry that shows that tax collecting costs of our companies who are already collecting in 1, 2, 5, to 10 States are about 14 to 15 cents for every dollar of tax collected. That is 6½ times greater than the average collection cost for an average retail store.

On top of this—or, actually, a part of this cost is dealing with audits. I didn't hear the retailers mention the fact that sales and

use tax audits are a frightening thing. If you have one State to deal with and it is your home State and you have some political pull in the State, it is a little bit better. If you are a Virginia catalog company audited by California, it is an entirely different matter.

I had a discussion with the tax attorneys at Sears one time. It turns out the reason there are two Sears Towers is one is filled with sales and use tax records so they can withstand audits. They are "entertaining" 10 to 15 auditors at any one time all through the year.

Now most of our companies are not as big as Sears used to be but, still, for any company over about $20 million, it is a risk of having an audit from a State where you have no political connection and you have to travel to their State in order to defend yourself.

What about the future? Is the trend getting dire? I mean, is this an industry out of control that is growing by leaps and bounds?

Our growth rate is 6 percent instead of 5 percent. We are growing faster than retail right now, and much of that growth in the future could be the information superhighway, and we hope so. But the information superhighway has nexus implications, meaning that there are tax collecting implications of getting involved in the electronic connections with your customers. So, all of this new technology and this new marketing ability may have tax consequences that eliminates the problem.

We have no evidence right now that the problem is growing at all. Matter of fact, in the last 5 years, many major companies have begun tax collecting where they weren't before. Spiegel, 6 or 7 years ago was not collecting except in two or three States. Now they are collecting everywhere. They bought Eddie Bauer. They bought Honeybee. They have got some stores, and there is a consolidation.

More and more of the sales are concentrated in larger companies that are involved with the major States, and more and more of this tax is being collected.

Let me make two points about provisions in the bill that were mentioned. The in-lieu provision is an option given to direct marketing companies if this bill were to pass to collect—instead of according to the 1,400 plus rates in Texas alone, they could collect a blended rate for the entire State. Which would mean, for example,—and I haven't really looked this up, so bear with me—charging your Dallas customers a half a percent less than they really owe and charging your Austin customers a half a percent more than they really owe.

Well, that is a great option for a mail-order customer—for a mail-order business, I say sarcastically; we cannot afford to break trust with our customers by charging any of our customers more tax than they actually owe, particularly for the benefit of our company having lower collection costs. There is no way that any consumer marketer could charge customers that way and get away with it.

Our business is based on trust. People send their checks through the mail, out into the vast unknown, and hope to get the product back. This is a business based on trust.

I also trust that a business customer would not be willing to pay one penny more in tax. They would know exactly what their tax

rate is. So, if you are dealing with a business entity, this blended rate wouldn't work, either. That puts us back to square one on that, and I have already described the complexities that are built in there.

Second, the exemption level—that is to say, the threshold—is at 3 million right now. Well, a previous bill had it at $12.5 million. In the 1980 SBA definition of a small mail-order house was anything $12.5 million or less in gross annual sales. That is now up to close to $20 million a year. That would be a more realistic exemption for small businesses.

But, as I explained, this is not just a small business problem. As soon as you put in a threshold, you have put in a ceiling.

Sure, you have allowed them to operate for a time without the burdens of this particular legislation, but, at some point, they are going to be trying to grow beyond that point. If the difference between an $18 million business and a $22 million a year business is having to collect taxes for 6,000 rates, submitting yourself to 45 to 46 different potential audits, filing all these monthly returns, et cetera, then it won't happen. They will either be bought up by larger companies or they will indeed not grow, purposely not grow.

Solid waste was mentioned. What was not mentioned is that catalogs are recyclable and that responsible communities have found ways not only to break even on the recycling of catalogs and other direct mail pieces but sometimes they can make money on that. It is 2 percent of the landfill, but, again, these are products and information that the consumer wants and uses. Sometimes they don't even use them to buy. They look through and they cut them out for school and whatever or they get ideas to shop elsewhere.

But the consumer is actually—this is the consumer's garbage, not the out-of-State marketers' garbage, and that is what the courts have decided on this issue, and it also reflects the truth of the matter. Any customer that does not want to be on any mailing list needs only to call or write to the merchant or to use our mail preference service.

Finally, it is not the position of the DMA nor our industry that we do not want these taxes collected. We are opposed to an insensitive approach which ignores of the differences between the method of collection through the mail and the method of collection at the cash register.

A retail customer can just say, here, tell me what I owe. We would like the tax to disappear for our customers, like it does for retail customers where they don't really even take it into account. But when you put it on an order form and rub their noses in it and make them multiply 6.25 times $38.95, that is not a level playing field. So, that is what we are objecting to.

There are some methods of collecting right now—the State of Maine has a way of collecting it directly from their taxpayers. It has worked to the tune of $2 million approximately in the first year without any enforcement efforts at all. If that is true, then there is a possibility that 20 to 25 percent of the revenue could be collected at no cost to Government with no burden and no collateral consequences at all. Maybe more can be collected this way. We don't know.

The system used in Maine is just putting a line on the income tax form and making sure that if it is not filled out and signed under the penalty of perjury, that a standard tax for their income level is added to the bill and that is assessed to them.

The other method—the one I prefer and I spent a couple years of my life involved with—is this voluntary collection agreement, which I believe is the way to go. Not just because it would get money to the States, a lot of money to the States and the local governments without burdening our companies that don't want to be burdened with this, but also because it would put pressure on the whole institution, I mean, the State and local governments to do what they really want to do anyway, which is simplify the system so that it is not such a burden on the entire national marketplace.

I know from talking to Sears, Penney and others, their tax departments, that this is a big burden for them. It is hidden because they have a large sales base to spread it over. It would be worse for smaller companies, but it is still a burden.

Even for the big companies, it is not true that can they do it without problems. They do it, but it is not without problems, and they are anxious.

A big supporter of the voluntary collection agreement and all these negotiations and present at every meeting were the Sears tax attorneys. Not because they would derive any immediate benefit, but they knew that eventually, if there were tax simplifications that were voluntarily agreed to by the States in return for more revenue, they would be the eventual beneficiaries to the tune of many millions of dollars.

Well, I think that that would be the way to go, and if Congress has any role in this at all, I would think it would be to encourage the States to look to that kind of agreement where they can get the money and they can do some simplification without the Federal Government telling them what to do.

Thank you very much.

Chairman BILBRAY. Thank you. I have got the impression you have made this speech before for some reason.

[Mr. Levering's statement may be found in the appendix.]

Chairman BILBRAY. But you mentioned the main situation, of course, that has been brought in, $2 million, but the estimates are much higher if their sales tax was collected. A State like my own that has no State income tax, that is not an option.

Mr. LEVERING. There is an option. It is much more difficult. You could send a separate form. You could say, here is the average tax for your income level. If you had fewer purchases than this, then fill this out and send it back. It is much more difficult.

Chairman BILBRAY. You had mentioned the voluntary agreements or the cooperative agreements between States and the mail-order houses. What about—as I understand, it was your organization or at least some members of your organization that had approached and had worked on this idea, an across-the-board sales tax that would be firm and then divided amongst States between the dollar business done in each State. Was that your organization?

Mr. LEVERING. To tell you the truth, I don't know of that particular proposal—we have heard of a lot of things. I don't know of a proposal that is worthy of the name that has gone anyplace.

When negotiating with the States, a key element of the voluntary collection agreement is its voluntary nature. I should say that the cost of nexus avoidance, that is, staying out of States, is so high for our big, aggressive entrepreneurial companies that they would gladly, in many cases, collect the taxes if the States could make it simple enough. They would rather free their marketing department to do the things that they do best, make money, and not worry about the tax consequences as long as the tax disappeared for their customers. That is the problem.

Now, as part of this voluntary collection agreement, we propose that there be a uniform 4 percent across the whole Nation tax. The States did not agree to that. They said, no, we can't do that. But they did agree to one rate per State, and we could have that the base rate so that any county rates and local rates in excess of the base could not be collected and States would have to share some of our revenue with them.

Chairman BILBRAY. But that is the argument you made earlier that a person in Austin might be paying more than the person in Houston or Dallas. Because of the difference, they have a different rate.

Mr. LEVERING. Right.

Chairman BILBRAY. The 4 or 5 percent rate would be the lowest of all entities, and that is what you would propose.

Mr. LEVERING. That is what we were pushing for. We didn't get it in the agreement. Since it was voluntary—we told the States, we think we can agree to this, but we think it makes the agreement less attractive to our membership. I still can promise you "X" billion dollars in taxes, and I did that. But I also told them that it would have been more had you been able to agree to a uniform national rate.

Chairman BILBRAY. Thank you. Mr. Portman?

Mr. PORTMAN. Thank you, Mr. Chairman. Interesting perspectives shared this afternoon.

I guess my question really goes to your last point. I understand the complexities of trying to collect the tax, the administrative burden, the fact that we do have a lot of different tax rates around the country. Just as a matter of principle, I believe that we should be simplifying all taxes, including individual rates. I think we would find enforcement problems were not so great, we would have higher collects and people would just understand better what they were getting for their money.

But you had mentioned that you could live perhaps with a small business threshold which was lower so that more businesses were considered smaller businesses, that you could live with some sort of a compromise that involved the so-called voluntary agreements between the States and with major retailers. Could you flesh that out a little further in practical terms how that would work?

I think you mentioned L.L. Bean. The State of Maine, as I understand, has a different approach which is on their State income tax. From what you said, it sounds like customers are asked to put their purchases down on the form. Then there is a percentage, which is sort of a flat rate, taken from those purchases so someone could keep a list, for instance, for every jacket or every pair of

boots or every shirt and then at the end of the year provide that information on their tax form.

But how would your compromise work that you had talked about, for instance, the voluntary agreement in the State of Maine?

Mr. LEVERING. Let me first correct what may have been a misimpression. We cannot live with any threshold because we are opposed to the legislation. We think that a voluntary arrangement is fine. If it turned out——

Mr. PORTMAN. No threshold in the voluntary arrangement at all?

Mr. LEVERING. There is no threshold because if you think you are unable to collect it either because you are too small or your business is not suited to that, 85 percent check payers, for example, then you would not join this voluntary arrangement.

We have the top 20 percent produce 80 percent of the revenue. Well, of our biggest 20 percent, there are a large number of companies who are interested in this, and I am counting on that because they have told me, and I am taking it seriously, and we went to the bargaining table with that. For them, here is what would happen. They would have one set of—by the way, this is described in detail in the addendum to the testimony. But, basically——

Chairman BILBRAY. I can put your entire testimony in the record if there is no objection. Hearing none, it will be included.

Mr. LEVERING. But, basically, it is collecting at one rate per State. It is filing a common form that would be the same for every State and actually filing it only with one entity, whether it is the Multi-State Tax Commission on behalf of all 50 States or however many join the compact or your home State that shares the information. But only one filing and subject to only one audit from one entity. They would pick it. Those kinds of things.

In return, you are in the position of not having to worry if hooking up with America On Line is going to involve you in a nexus situation in these four or five States and things like that.

Mr. PORTMAN. Just to take it down to the level of the customer then, the customer would see nothing in terms of an order, for example.

Mr. LEVERING. That is right. The customer would just see residents of Virginia please remit and then they would have a tax rate. But instead of having a blended rate, which would be different from any rate the customer had ever seen before and would in some cases be more than the local rate and would raise all kinds of questions and would flood the phone lines, it would be a rate that they would soon recognize as the mail-order rate and would be lower, if anything, or the same than what they are used to paying.

Mr. PORTMAN. One final question, Mr. Chairman. With regard to the Maine experiment, you indicated that is something fairly recent. Is that within the last couple years?

Mr. LEVERING. Last couple years.

Mr. PORTMAN. You said I think a 20 to 25 percent collection rate roughly.

Mr. LEVERING. Twenty to 23 percent the first year. I don't know what their receipts were the second year.

Mr. PORTMAN. This is without notification, certainly without enforcement, you said.

Mr. LEVERING. Right.

Mr. PORTMAN. Is there any other State considering this, given that record, which I think is probably considered pretty good?

Mr. LEVERING. Yes.

Mr. PORTMAN. Without enforcement and notification, are there other States considering that?

Mr. LEVERING. I think there are. Perhaps even Virginia.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman BILBRAY. Mr. Hilliard?

Mr. HILLIARD. Yes, Mr. Chairman, I have several questions.

Let me ask you, first of all, in testimonies of your representation, this Direct Marketing Association represents not only those who put out catalogs but does it also represent those that sell through other media, like radio and TV and so forth?

Mr. LEVERING. Yes.

Mr. HILLIARD. The public telephone?

Mr. LEVERING. Any direct response. If you can place an order without going into a store or having someone come visit you, and there is a way of——

Mr. HILLIARD. So you represent the full industry.

Mr. LEVERING. Yes.

Mr. HILLIARD. Complete industry. I understand that your industry is against collection of any tax at any rate.

Mr. LEVERING. No, we are against Federal legislation that would mandate collection by all the companies, those who can do it and those who can't, even if they simplify it. Right.

Mr. HILLIARD. So you are against the bill, the Senate bill.

Mr. LEVERING. We are against the Senate bill. That is right.

Mr. HILLIARD. All right. Now I understand what you mean when—I agree with several things you said earlier in terms of insensitivity. I agree with what you said about garbage. I realize that all garbage is local. I realize what you said about taxes, every tax is a burden. But I would think that your association would consider its members as being good corporate citizens.

Mr. LEVERING. Yes, we do.

Mr. HILLIARD. It is hard for me to find an appreciation for your association viewpoint. I know no one wants to pay a tax. But there are certain infrastructures that are in use, that your company benefits from.

Mr. LEVERING. Like what?

Mr. HILLIARD. Your association, your members benefit. I understand what you say in terms of the local companies paying shares or paying a part of the cost of maintaining road or whatever it may be.

Mr. LEVERING. Right.

Mr. HILLIARD. But all other companies also pay a share of those responsibilities, and they have to pay those local taxes.

The only thing I am saying, it seems to me that your association really wants the burden on the State.

The idea about the voluntary agreement, to me, is alien. We never would get tax collected in this country if we put it on a voluntary basis. To me, this is a very serious matter, simply because of the fact that you have—especially where it relates to my State—

you have better than 6 percent discount advantage over local companies that do pay all of these tax burdens that you wish to avoid.

I know that you are pushing the voluntary settlement agreement on behalf of your association, which is great. But things are different here on the Federal level, and I just got here. But on the State level, when organization representatives came and sort of gave the type of presentation you gave, we would just simply take the matter out of the hands of those who wish to compromise and we just go on and take care of the people's business.

Mr. LEVERING. I am not sure I understand that. But I will respond to two points.

Mr. HILLIARD. I know we will do what we have to do.

Mr. LEVERING. All right. Well, I can assure you that the voluntary agreement is not entirely voluntary. What you have got is a situation right now that is very painful for many of our larger members. To get relief from that pain, they could collect taxes. In other words, they are restricting their marketing and not going into States with things that might be nexus producing, might have tax consequences and thereby restricting their business. They don't want to do that.

But the pain of having to collect under the current system is too great. If you lowered the pain level, they would volunteer not because they are great guys, because people don't want to collect taxes from their customers, but because it is a better business decision for them to do so.

A second point I would like to make about being good corporate citizens, I think we are good corporate citizens and we do pay taxes where we are located, where the warehouses are in Virginia and where the corporate headquarters are in another State—just as a store pays taxes, property taxes where they are. I understand that.

The sales and use tax is a special kind of tax that is levied on the services that the State provides, getting buyer and seller together. We pay for that, as well.

But Governments don't get our buyers and sellers together—we don't have the roads and the bus services and all the fire and police protection of local governments to do that. We have the postal service and UPS and Federal Express, and we charge our customers for that, and they charge a handsome fee, and we have to collect it. That is if we had a local outlet, we wouldn't have to pay all that, but we have to pay that. We don't want to have to pay shipping and handling and pay the tax, too, for the same service.

Mr. HILLIARD. Other than the paperwork burden, the cost of the software and the cost of maintaining the system, what other liabilities are there associated with this tax from your association's viewpoint?

Mr. LEVERING. A big one is the check-paying customer. I mentioned the fact that lots of errors come in, and they are almost always underpayments. Any time you get an error, you have to kick it out of the system and handle it manually somehow.

The other thing is that many of those customers that have to write it out are daunted by a form that requires them to do this kind of math and know that sending to Aunt Minnie in Florida I have to use a different tax rate. What is it? I will put it aside, get back to it, maybe.

Companies lose sales. They know they are going to lose sales, and they are afraid of losing too many sales to the complexity of the order. We have built our industry on convenience, and the most inconvenient thing to put on an order form is tax computation.

Mr. HILLIARD. I understand what you are saying. Let me say this. I wouldn't sell the public cheap. They generally add up all of the different items and the majority of them do it correctly.

Mr. LEVERING. We have done studies, and it shows the response rate goes down.

Mr. HILLIARD. If you have to make corrections, then you are auditing your own forms. But, I look at your mailing labels and you have quite a bit of information just on the label about individuals. I imagine, based on the information you have that doesn't show up on the label, everything about the individual, how much he bought a year through mail ordering.

Mr. LEVERING. We could know that. In many cases we can.

Mr. HILLIARD. Which means that if you can keep that record on the individual I would think that it would be very easy for you to keep it on a State or on a zip code.

Mr. LEVERING. Well, it seems that way, and it is easy to confuse sophistication with the ability to do these taxes. But there are plenty of very talented athletes, basketball players, maybe, who can't hit major league curve balls. Just because they are real good in one area doesn't mean they are good in another. We have got companies that are very good at collecting this information, but the tax stuff is a different matter altogether.

Mr. HILLIARD. Well, you may need some new computers.

Thank you.

Chairman BILBRAY. Well, Mr. Levering, thank you very much for your testimony. We appreciate all the witnesses today. We certainly have a record on this so that when the 104th Congress comes in next January, if they want to look at this matter, they certainly have something to begin with to look at this matter. Thank you.

Mr. LEVERING. Thank you, Mr. Chairman.

[Whereupon, at 3:40 p.m., the subcommittee was adjourned, subject to the call of the chair.]

APPENDIX

Opening Statement of Rep. James H. Bilbray
Subcommittee on Procurement, Taxation & Tourism
September 27, 1994

Today, the Subcommittee will hear from a wide spectrum of witnesses on the impact and fairness of giving states the power to collect from mail order catalog firms the sales taxes incurred from purchases made by out-of-state mail order companies.

The Subcommittee enters this hearing with an open mind but aware of a number of concerns that have been raised by the small business community in a number of areas

Currently, mail order sellers are exempt from collecting state sales taxes as a result of two Supreme Court decisions. In 1967, the Court in National Bellas Hess v. Illinois Department of Revenue held that out-of-state mail order firms and other direct sellers, who have no physical presence in a state, are under no obligation to collect and remit state sales and use taxes, even if they do business in a state. In 1992, the Court reaffirmed the 1967 decision but held that Congress may use its interstate commerce powers to uphold state collection requirements. Legislation is pending in the Senate which would mandate out-of-state companies to collect sales taxes for goods delivered across state lines.

The first panel of small businesses will present their views to the Subcommittee describing the price disadvantage they face when competing with mail order companies. Both small businesses and catalog firms sell the same quality products. However, a consumer can go down the street to their local computer store, price a system, and compare it with the same system in a catalog. On most occasions, the local retailer, who must collect the sales tax, will be at a competitive disadvantage to the mail order company who will not collect the tax.

The second panel, consisting of public officials, will enlighten the Subcommittee on the potential revenue loss for local governments and the public educational system. Two reports have been prepared to estimate the revenue loss from exempting mail order companies from collecting sales taxes. The Advisory Commission on Intergovernment Relations estimates that the revenue loss is around $3 billion a year. The Nathan Associates, on behalf of the Direct Marketing Association, concluded that the amount of uncollected sales tax on interstate mail order sales was $1.38 billion. Whichever figure you belief, it is a substantial amount of money.

And finally, the third panel will consist of witnesses from the mail order industry.

I welcome everyone and look forward to receiving their remarks.

Opening Statement of
Earl F. Hilliard
Member of Congress
before the
Subcommittee on Procurement, Taxation, and Tourism
September 27, 1994

Mail order sales especially affect rural areas such as the Seventh Congressional District of Alabama. Since rural communities have a limited selection of available products within their neighborhoods, they use mail order outlets to purchase those items not available locally. Further, those localities tend to be poorer than the average, and they tend to provide fewer social services. Also they have a less extensive infrastructure, such as roads, and are often in great need of revenue for government on every level.

In addition, local businesses are penalized when they are required to collect such taxes. Their prices have to be higher than those of the mail order firms. This allows a competitive advantage to mail order firms, which not only can charge lower prices, but can sell to a broader consumer base in interstate commerce. This helps to lower costs even more by the volume of their sales. With the simplicity of computerization available today, I believe that there is no excuse for this unfair competition against local businesses.

It is fortunate that this is one of those moments when technology seems to be in step with the needs of America. We are no longer in the "pencil and paper" era Now, a computer can easily use a data base that contains all of the necessary tax information. That data base could logically be maintained by the government, possibly by the U.S. Department of Commerce. Programs can be written easily that can calculate the exact taxes required for a locality when an address is entered. That specific information can automatically be placed into particular databases for each tax-receiving municipality, county, and state. The computers of today can then compute the totals and automatically cut a check for the taxes collected. Indeed, all the bookkeeping needed can be done by a well-programmed computer.

Because of the efficiency of computer technology, I have trouble accepting the arguments from the "pencil and paper" era that it is too difficult for the companies to process the required revenues. It appears that the companies in the mail order business are really competing unfairly and have no excuse for continuing to avoid collecting the taxes for the various jurisdictions.

Statement Of

JOE BOOKWALTER

Concerning

COLLECTION OF STATE AND LOCAL SALES TAX

ON INTERSTATE SALES

Before the

House Committee on Small Business

Subcommittee on Procurement, Taxation and Tourism

September 27, 1994

Mr. Chairman and Members of the Committee:

My name is Joe Bookwalter. For the past nine years, I have been President and co-owner of Baker Appliance & Video, Inc., a 41-year-old business headquartered in Carson City, Nevada. In addition to our Carson City location, we have three other stores, in Reno, Fallon and Minden.

We currently have 47 employees.

Major home appliances -- "white goods" such as refrigerators, freezers, ranges, and the like -- account for about 70% of our sales volume. The other 30% is attributable to consumer electronics products, such as TV sets, stereo equipment and video cameras and recorders.

In addition to operating my company, I've been an active member of my industry's national trade association, the North American Retail Dealers Association. I currently serve on NARDA's Board of Directors and am Vice President of the Association.

I'm here this afternoon to urge your support for legislation such as the Tax Fairness for Main Street Business Act (S.1825) which would enable me to compete fairly with out-of-state companies that take advantage of a "loophole" in current sales tax collection laws.

My business has survived for more than 40 years by providing exceptional service and knowledgeable sales consultants. But the proliferation of mail-order catalogs and toll-free telephone numbers in my industry has caused a very evident increase in the number of customers who use our store and its trained personnel to

select their stereo equipment, video cameras and recorders, then buy them out of state. The fact that they are obligated to pay a state use tax on their purchase just doesn't seem to sink in. Then, when their high-tech equipment requires repair or adjustment, they bring it to our full-scale professional service department and expect warranty repair, which we are obligated by agreement to provide by many of our manufacturer suppliers. Our choice is to refuse to provide the service and eliminate the possibility of future sales to this customer, or to "cheerfully" provide the service at our expense.

The interstate sales tax "loophole" also hurts our appliance business as well. Our stores are located near Lake Tahoe, where it's not uncommon for home builders to spend $25,000 or more for kitchens in their new construction or major remodeling projects. The appliance share of that expenditure represents a major piece of business for our store -- if we weren't competing with suppliers across the border in neighboring California.

I know of many home builders who regularly purchase kitchen appliances from suppliers in the San Francisco Bay area. These appliances are sent via common carrier to Nevada, so that the seller does not have to collect our state's sales tax, which ranges between 6-1/2-7%. Even though the contractors are obligated to pay our state's use tax on their purchases because they do not qualify as resellers under our state's law, they rarely do so. Our state

loses revenue and I've lost a major sale. We have no problem competing on price, the "tie breaker" is the out-of-state seller's 7% sales tax "advantage."

Because one of our stores is only 18 miles from the California border, someone might argue that we can take advantage of the same tax collection exemption afforded out-of-state competitors. But we can't. We do a substantial amount of business in California, we're registered to collect that state's sales tax, and we do collect California tax on our deliveries into the state.

This, then, is the trend: to leave out of the sales "loop" the Main Street merchant who supports a manufacturer by investing in his products. The merchant displays products in a retail store, with all the accompanying costs, attracts potential end users by expensive advertising, demonstrates products to the retail buyer, sometimes haggles over price, arranges the financing (often having to provide it himself), provides costly, highly-skilled service (usually at a loss), and absorbs the losses from the uncollectible accounts.

As a Main Street retailer, I am further placed at a disadvantage by being required to collect state and sometimes local sales taxes while my out-of-state competitor has no such responsibility.

I know from that this problem is not limited to the appliance and electronics business. I submit to you that this unfair competition is a problem for all retailers and that it will become even more of a problem in the future with the growth of the so-

called information superhighway and the increasing use of television and computer networks to sell merchandise.

Mr. Chairman, I appreciate the opportunity to come to Washington to explain to you and members of this Subcommittee first hand a problem which confronts retailers like myself every day of the year. I strongly urge the Congress to pass the Tax Fairness for Main Street Business Act because it will remove an unfair advantage that my out-of-state competitors now enjoy and will enable me to compete on a more equal footing with these companies, which are threatening the very existence of small businesses like mine.

·NSBA·

Excellence and Equity in Public Education through School Board Leadership

TESTIMONY

on behalf of

THE NATIONAL SCHOOL BOARDS ASSOCIATION
in conjunction with

THE NATIONAL EDUCATION ASSOCIATION
and
THE AMERICAN ASSOCIATION OF SCHOOL ADMINISTRATORS
on

THE TAX COLLECTION OF MAIL ORDER SALES

before the

Small Business Committee
U.S. House Senate
Washington, DC

September 27, 1994

presented by

Raymond Byers
Vice President
Novi Community Schools
Novi, MI

TABLE OF CONTENTS

I. INTRODUCTION

My name is Raymond Byers. I am pleased to be here today and I appreciate the opportunity to testify about the need for legislation that would close a gaping loophole in our tax laws and prove to be an enormous benefit to our nation's school children.

I have been an elected member of the Novi Community School's Board of Education for 9 years. I am here today on behalf of the National School Boards Association (NSBA), the Michigan Association of School Boards (MASB), the Novi Community School Board and the over 95,000 local school board members responsible for governing local public school districts across the nation. This statement also has been endorsed by the National Education Association, which represents over 2.2 million public school teachers, education support personnel and higher education faculty, as well as by the American Association of School Administrators.

II. PUBLIC SCHOOLS RELY ON STATE AND LOCAL TAX REVENUE

I am here to discuss an inequity in our tax laws. It's one that can easily be remedied, and one that -- once corrected -- will send an estimated $3.9 billion into the state and local funding stream. The relative health of the revenue stream at the state and local level has a considerable impact on the ability of public schools to deliver quality education. Public school districts obtain over 90% of their budget from state and

local governments. In fact, in the 1990-91 school year, 48.3% of the revenue used to run our schools came from state governments, 44.5% was provided at the local level and the remaining 6.2% was provided by the federal government. Clearly, an additional $3.9 billion in tax revenue collected at the state and local level will have a large impact on the public school system. Today I would like to discuss the problem that a bill like S.1825, Tax Fairness for Main Street Business Act of 1994 would remedy, and then describe the ways in which such legislation would have a large impact on our public school system.

III. THE CURRENT PROBLEM

Currently, out-of-state mail-order businesses may owe sales and use taxes, but, oddly, they are not required to pay them. This situation resulted from a 1967 United States Supreme Court decision in *National Bellas Hess, Inc. v. Department of Revenue of Illinois.* In that case, the Supreme Court held that an out-of-state mail-order company did not have enough direct connection or "nexus" to be absolutely required to pay the sales and use taxes it owed. They also claimed that such a requirement would burden interstate commerce.

In 1992, the Supreme Court moderated its stance in *Quill Corporation v. North Dakota.* That case held that the "nexus argument" no longer was viable, but maintained that states are still prohibited from requiring out-of-state mail-order companies to remit

state and local taxes. With the tax collection ban still in place, though, the Court recognized that states and localities have a huge loss of revenue and local businesses are at a real competitive disadvantage to mail-order firms. The Court decided that this is a matter rightly resolved by Congress.

IV. THE SOLUTION: INTRODUCE AND PASS THE LEGISLATION THAT ALLOWS FOR MAIL ORDER SALES TAX COLLECTION

I believe that, in the Tax Fairness Act, the Senate has tried and Congress has found a solution. The Senate legislation permits the collection of state and local taxes owed by out-of-state mail-order firms. It puts an end to the significant revenue loss now suffered by state and local governments and gives local businesses a more level playing field. The Tax Fairness Act is quite moderate in its approach. It exempts any mail-order company that has less than $3 million dollars in sales when its sales in the state are less than $100,000. It also requires states to provide access to information and forms to facilitate the process of remitting the taxes. Let me emphasize one key fact -- S. 1825 is <u>not</u> a bill which <u>increases</u> taxes -- it simply provides the authority for state and local government to collect taxes already owed.

V. TAX FAIRNESS BENEFITS ALL SCHOOLS

Now I'd like to tell you how this bill would help school children. This connection becomes clear when we examine the major sources of revenue for states and localities

to fund schools. For states, most school funding comes from general revenues. In 1990, 32% of states' revenues came from personal income tax and a full 33.2% came from the general sales tax. Locally, property tax is the typically main source of tax revenue with other taxes such as sales and income taxes also in the mix. However, in Michigan, we have just enacted a dramatic shift away from the property tax to using the sales tax for funding our public schools. Undoubtedly, then, the infusion of $3.9 billion in sales and use taxes will make a significant contribution to the pool of funds available for education.

VI. <u>SCHOOLS PROSPER WHEN STATE AND LOCAL GOVERNMENTS PROSPER</u>

There are three levels of impact that will be felt by public schools if this bill becomes law. First, every school district in the country stands to benefit from the boost to the fiscal health of state and local governments. And in recent years, we have seen state and local governments struggle to maintain fiscal strength. Shrinking budgets and diminishing property values have meant hard choices.

State and local policy-makers recognize that their decisions literally determine what resources will or won't come into our school children's hands. Do we fund that hospital wing or develop that high school science program? These are real problems. A recent study analyzing school facilities found that fully 74% of our nation's schools need to be replaced or extensively modernized in order to be appropriate learning

environments. As lawmakers, you understand all too well these dilemmas and as a school board member, I am on the front lines of those impossible decisions. The $3.9 billion that the collection of mail order sales taxes would bring to state and local governments will help those governments out of this fiscal bind. Many states will have a little more freedom in making those tough choices and will be able to more fully invest in the future of our school children.

Schools also will benefit generally from the equity put back into local business. Local small businesses no longer will be in competition with an out-of-state mail order goliath with a tax break. They will have a fighting chance to prosper and their prosperity will be felt in the community, in the property values, in the tax base and, therefore, in the schools.

VII. BELLAS HESS LAWS IN THE STATES

There is a second level of impact on schools that the collection of mail order sales taxes will bring. There are several states, including my home state of Michigan, in which education stands to get a direct boost from this bill. Those states have decided to dedicate to education all or most of the new revenues raised from collecting mail-order taxes after this federal loophole is closed. In Michigan, for instance, 60% of the first 4% and 100% of the next 2% in mail-order sales taxes will go to schools. The Michigan School Boards Association estimates that, once the Tax Fairness Act goes into effect, $60 million new dollars will go to Michigan schools. The only

impediment to bringing these much-needed funds directly to schools is inaction by Congress.

VIII. SALES TAXES THAT FUND EDUCATION

Finally, there are at least ten states that have earmarked all or a portion of their general sales tax revenue for education. In those states, of which Michigan is one, the taxes collected as a result of the mail order sales tax legislation will have a direct benefit to schools. Those new taxes will increase the pot of money that already has been dedicated to education. It is worth noting that while earmarking a variety of revenue streams is a widespread phenomena, the sales tax has been by far the most popular revenue source to earmark for education. That makes legislation like this even more critical for schools.

Several states have a particularly high reliance on sales taxes to fund their education programs. In South Dakota, 56.8% of their local contribution to the education budget comes from local sales taxes. In Louisiana, the sales tax provides 55.1% of the state share. In Michigan, 37% of school funding is from sales revenues. While not as large as other states, it is the highest single source of revenue for schools in Michigan.

IX. CONCLUSION

In conclusion, Mr. Chairman, NSBA and the Michigan Association of School Boards, along with the National Education Association (NEA) and the American Association of School Administrators (AASA), urge the Committee to support public education by introducing and passing legislation that allows states to collect mail orders sales taxes. This legislation is of paramount importance to our nation's school children and will provide critical dollars for state and local governments to invest in education. NSBA, NEA and AASA would be happy to assist the Committee as you address this issue.

On behalf of the Novi Community Schools, MSBA, NSBA, NEA and AASA, I thank you again for the opportunity to testify before the Committee.

TESTIMONY

OF RUSSELL COHEN

ON BEHALF OF

JEWELERS OF AMERICA

BEFORE THE

HOUSE SMALL BUSINESS SUBCOMMITTEE

ON PROCUREMENT, TAXATION, AND TOURISM

SEPTEMBER 27, 1994

Mr. Chairman and Members of the Committee:

INTRODUCTION

I am Russell Cohen, Chairman and CEO of Carlyle & Co. Jewelers. We operate 82 stores in eleven states including retail locations in states represented by four members of this subcommittee. We are headquartered in Greensboro, North Carolina.

We are a privately held company, begun 72 years ago by my grandfather who opened our first retail store in Greensboro. We now operate under the trade names of Carlyle & Co., Jewel Box and J.E. Caldwell & Co. At our peak employment period, during the holiday season, we have 875 employees.

I appear today on behalf of the Jewelers of America (JA), a retail trade association comprised of over 10,000 retail jewelry store members representing 17,000 outlets operating in all 50 states. I am the former Chairman of the JA Government Affairs Committee and served on the Board of Directors' Executive Committee. JA is an active member of the Coalition For Fair Collection of Interstate Sales Taxes[1], which has endorsed this testimony.

The Jewelers of America strongly supports Senator Dale Bumpers' legislation, S. 1825, and welcomes this opportunity to explain why. It is based upon two foundations: fairness and the vitality of local communities. This legislation, if enacted, would contribute to both of these goals in a meaningful way.

As a matter of public policy, Congress should do all in its power to encourage local businesses, local employment opportunities, and the well-being of local communities.

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[1]The Coalition for Fair Collection of Interstate Sales Taxes is an ad hoc coalition comprised of national, state and local business trade associations and thousands of individual businesses across the country. While the Coalitions is comprised only of business members, it is working closely with a variety of other organizations to pass legislation requiring interstate sellers to collect state and local sales taxes. Some of the organizations working in cooperation with the Coalition include: American Federation of State, County and Municipal Employees; Federation of Tax Administrators; Government Finance Officers Association; Multistate Tax Commission; National Association of Counties; National League of Cities; National School Boards Association; and United States Conference of Mayors.

FAIRNESS IS AT THE HEART OF THE PROPOSAL

When the Supreme Court decided the Quill Case, it threw down the gauntlet to the Congress: "Congress is now free to decide where, when, and to what extent the states may burden interstate mail-order concerns with a duty to collect use taxes." As we see it, S. 1825 is a response to that Supreme Court statement and is all about fairness to local retailers and to state and local governments, who would be permitted to efficiently collect taxes that are legally owed before they are forced to raise additional taxes or curtail vital programs to make up for these lost revenues.

When re-examining the doctrine of the Bellas Hess case ruling in 1992, Justice Byron White questioned the "rationality of perpetuating a rule that creates an interstate tax shelter for one form of business – mail-order sellers – but no countervailing advantage for its competitors." In similar fashion, when introducing S. 1825, Senator Bumpers stated, "I have done my very best to level the playing field for Main Street America. I have done my very best to keep faith with the States, on whom we continue to impose mandates at the Federal level without giving them the money to fulfill those mandates."

SOME ILLUSTRATIONS OF UNFAIRNESS TO RETAIL JEWELERS

Here are some examples of how some local retail jewelers are being hurt today by the failure to legislatively repeal the Bellas Hess case ruling.

Fine watches are an important part of retail jewelry merchandising. The average Rolex watch sale in our business is around $4,200. One of the nation's largest retail jewelry stores frequently takes out full page ads in the national edition of the New York Times advertising many fine watch lines like Rolex. If a North Carolina resident orders by mail or over the phone, he or she does not pay the six percent North Carolina sales tax. It is a significant advantage, even though we match the New York selling price, we lose the sale.

Under North Carolina law, a North Carolina resident is obligated to pay a use tax on out-of-state purchases, but the simple fact is that enforcement of the use tax payment is ineffective. The bottom line is our firm loses a sale, North Carolina loses the sales taxes that would have collected, and the state never receives the use tax. Thus, North Carolina businesses and

the state are losers. Meanwhile, if payment is not made on that sale, the New York firm or a credit card company will use our North Carolina court system to collect the debt. If there is a warranty complaint, our State Attorney General's office will investigate, but these state services will be subsidized by businesses like mine that collect sales taxes, while the out-of-state company has a "free ride." To continue this policy simply makes no sense, and that is why we need S. 1825 or a bill like it, to correct this inequity.

In our industry, we are especially vulnerable to mail order sales of branded items over $500 in value. Such world renown items made by LaLique and Steuben come to mind as merchandise that could be easily ordered by mail or over the phone. Why would the customer choose to pay the sales tax if that customer knew the equivalent use taxes on mail order sales can be ignored with impunity. In some of our stores we have a boutique featuring products of one well-known "name brand" retailer. Our employees have assisted customers with gift selections only to have the customer walk away and order the merchandise directly from the New York headquarters of the "name brand" retailer. Thus, when we lose a sale to a customer to avoid the payment of taxes, we lose, and North Carolina loses.

I have heard it said that for those who use mail order, it is the convenience and not the tax savings that matter. Based upon our experience in the greater Philadelphia area where our J.E. Caldwell & Co. store is centered, I can categorically say that in the case of retail jewelry sales, taxes do matter. On countless occasions, too many to enumerate, our Philadelphia stores' clientele will do their "shopping" at our stores in that city and then drive to our Wilmington, Delaware store where there is no state sales tax to do their buying.

S. 1825 IS A BALANCED BILL

Let us be clear that notwithstanding the smokescreen being set up by direct marketing companies and their national associations, S. 1825 is not a new tax. There are five states in which there is no sales tax and there is no likelihood they would consider one if S. 1825 were enacted. Thus, it is in no way a new tax.

We believe S. 1825 has been constructed so as to ensure there is no undue burden on businesses generally, and small business in particular. Four

provisions, especially, come to mind that demonstrate the even-handedness of the legislation:

1) The de minimis exception in Section 3 offers a meaningful small business threshold. As a result, it is estimated this threshold has effectively excluded 93 percent of all mail order companies. Thus, the firms that would be covered are substantial ones, and have the computer capability to make compliance a relatively easy matter.

2) Direct marketing proponents erroneously assert that a firm would be remitting to 6,100 local jurisdictions. In S. 1825, there is an option to choose a so-called "in lieu" fee (Section 4(b)(2)(B) and (3)) which makes a single-rate option available to every customer.

3) Minimizes paperwork by calling for quarterly filing (Section 8).

4) Mandatory toll-free consumer hot lines are required to be established to provide information, as a pre-condition to collect state or local taxes.

INTERACTIVE SALES

As we enter an interactive television era when conventional merchandising will be turned upside down by TV shopping networks, Congress should be thinking about changing the climate to allow states to make a demand on out-of-state firms to remit a use tax on these sales. Otherwise, Congress by its inaction will continue the inherently unfair system that places "Main Street" firms at a competitive disadvantage.

I note this quote from a recent article (March, 1994) in the New York Times: "Industry executives predict that home shopping, already ringing up $3 billion a year in sales, could soar to $25 billion a year by the end of the decade...home shopping is likely to be retailing's fastest-growing sector for the next several years." The Managing Director of the Yankelovich Partners of Westport, Connecticut, predicts that 40 percent of American households will have tried home shopping by the end of 1996, compared with only ten percent today.

I am happy to share this panel presentation with a representative of the Home Shopping Network, Inc. to acknowledge that they do collect taxes from their customers and remit the proceeds to appropriate state and local agencies. If this company can do it, so should others who meet the sales volume criteria in S. 1825.

CONCLUSION

Speaking for the Jewelers of America, we appreciate this opportunity to appear on this most important issue. We concede that the direct marketing industry has an enormous grass roots advantage with its well-established communications network, but we are committed to the task of winning approval of S. 1825. Mr. Chairman, we appreciate your joining Representative McCurdy's effort to put the provision in the welfare bill. To us, it makes sense to join the provisions of the bill with any legislation that mandates state responsibilities.

In conclusion, we at JA appreciate that you have called attention to this issue at this hearing. We believe that S. 1825 is legislation that America needs, and with its passage, Congress will have done something to insure the future vitality of Main Street America. S. 1825 does indeed level the playing field without harming the mail order businesses of this country.

TESTIMONY OF

ROBERT J. LEVERING
SENIOR VICE PRESIDENT,
CATALOG ISSUES
DIRECT MARKETING ASSOCIATION

CONCERNING

INTERSTATE SALES TAX COLLECTION

BEFORE

SUBCOMMITTEE ON PROCUREMENT,
TAXATION AND TOURISM OF THE
HOUSE SMALL BUSINESS COMMITTEE

SEPTEMBER 27, 1994

83-416 O - 95 - 3

Good afternoon, Mr. Chairman, my name is Bob Levering, I am Senior Vice President for Catalog Issues with the Direct Marketing Association. The Direct Marketing Association (DMA), with offices in New York City and Washington, D.C., is a national trade association representing over 3,000 domestic companies and organizations that market products and services through the mail, electronic and print media, and through telemarketing.

We understand that the purpose of this hearing is to gather information on the issue of whether Congress should grant states the authority to impose tax collection duties on businesses not located within their borders. DMA is strongly opposed to federal use tax legislation because of the burdens it would place on thousands of direct marketing companies and tens of millions of mail order shoppers. We also believe that the collateral effects of this legislation would be harmful to American society and the American economy. We are, therefore, happy to cooperate with this subcommittee in its fact-finding mission so that Congress will have a clear and complete picture of the consequences of legislation in this area.

The U.S. Supreme Court has ruled a number of times, most recently in 1992 in Quill v. North Dakota Department of Revenue, that absent Congressional authorization states may not impose tax collecting duties on out-of-state businesses. After examining the requirements of collecting taxes from customers in other taxing jurisdictions, the Supreme Court found that these requirements would place an undue burden on interstate commerce in violation of the Commerce Clause of the U.S. Constitution. Since it is a Commerce Clause matter, the Court noted that "no matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with out conclusions. (citation omitted) ... Accordingly, Congress is now free to decide whether, when, and to what extent States may burden interstate mail order concerns with a duty to collect use taxes." Thus, we are here to debate not whether Congress has the authority to grant states this power, but whether it is good policy and in the national interest.

Collection Costs are Greater for National Marketers

The linchpin of the argument for federal legislation is the claim that it is "only fair" for mail order companies to collect this tax. States and localities need the revenue and after all in-state retailers collect the tax. Let's "level the playing field", proponents say. They claim that it's the same thing for direct marketers to collect state use taxes as it is for retailers to collect state sales taxes. This is simply not true. The cost of collecting taxes through the mail has been documented to be on average 14 cents for every dollar of tax collected, about six times the collection cost for retailers. And here is why.

For a retail store, the tax is determined by the location of the store. All of the applicable taxes -- state, city, county, transportation district, sewer district, water district, etc. -- are added together to produce a single rate which is programmed into the computers and cash registers and everybody pays the same rate on the same list of exempt items.

For the direct marketer, the amount of tax due on any individual sales transaction is determined by the shipping address. That is to say, the home or maybe the office, or summer residence of the buyer or in many instances the address of a gift recipient. Forty-five states and the District of Columbia have sales and use tax laws and each one of them has a different schedule of exempt items and each of them treats the taxation of shipping and handling charges, extended warranties, service contracts, etc. In addition, there are over six thousand different local taxing jurisdictions that have their own rates on top of the state rates.

Thus, if you own a store and you have half a million customers, you still collect only one tax according to just one set of exemptions, file returns with only one state, and are subject to one state audit. If, on the other hand, you own a mail order business with

the same number of customers and this federal legislation were to pass, then you could easily be dealing with 6,000 different rates, 46 different sets of rules and 46 potential audits.

Supporters of the legislation attempt to trivialize these collection burdens by pointing to computer programs that greatly assist in dealing with the myriad of local rates. These programs are necessary and helpful as far as they go. They are also very expensive, and since there are hundreds of sales and use tax changes every month, companies need to pay on-going fees for updated information. Most importantly, computer programs do not solve the problems of dealing with different schedules of exempt items, nor do they help in dealing with the errors that result from millions of customers calculating their own taxes when paying by check.

Some people are confused by the fact that some catalog companies are already collecting these taxes. Yes, for large companies with a reason to be physically located in each taxing state <u>and</u> a very low percentage of check-paying customers, it is possible. Burdensome, but possible.

But most of the companies in our industry are nothing like J.C. Penney, which has a tax department, fewer than 1% check-paying customers, and $3 billion in annual sales. In fact, more than half of the companies that would be covered by the current federal legislation are over 200 times smaller than J.C. Penney and are classified as small businesses. For these companies the costs of maintaining the system would be a much greater percentage of sales revenue, and dealing with a greater number of check-paying customers would create additional costs and lost sales.

The complexities of trying to collect taxes through the mail would mean a decrease in sales and an increase in costs for most direct marketing companies. In short,

this tax proposal would not level the playing field for retailers, it would level the competition.

<u>Sales Would Be Lost Due to Added Complexities</u>

For larger direct marketers, it is the impact on their customers that they fear most: not the impact of the tax itself, but the complications that a tax schedule introduces into the ordering process. Direct marketing is a business built on providing convenience to customers. When asked why they purchase through direct marketing, customers consistently say: convenience, convenience, convenience, then selection of products and quality. Companies go to great lengths to simplify every procedure.

Even the appearance of complexity can depress sales. Last year Omaha Steaks removed two lines from its order form lines that were not for customer use and were just cluttering up the form (making it appear more complex). As a result of removing those two lines, response rates jumped almost 10 percent.

For check-paying mail order customers, use tax calculations are the worst kind of complexity. In order to write a check to cover the correct amount due on a mail order purchase, a customer must know the applicable tax rate, and then correctly perform the decimal multiplication problem to calculate the proper amount of tax due (6.25% times $38.95, for example). Companies know from experience in their home states that this process produces a very high percentage of errors and underpayments. Worse, many customers are daunted and never get around to placing the order.

Over 30% of the 100 million Americans who shop each year through direct marketing, pay by check; and our companies are convinced on the basis of their experience with complexities in the ordering process that if they are required to collect taxes under the current system, they will lose large numbers of those sales.

<u>Mail Order Companies Receive Fewer Benefits from the States Where They Have No Physical Presence</u>

One would think that these greater burdens would be justified on the basis of greater benefits -- but just the opposite is true. In-state retailers receive many tangible benefits from their states: police and fire protection, garbage removal, roads, educated work force, etc. When trying to list direct benefits to the out-of-state marketers, tax administrators have been forced to make far-fetched arguments. They have cited the services provided by in-state banks to facilitate customer orders. They have cited the removal of discarded catalogs as part of the garbage of in-state mail order customers. State and federal courts have rejected these arguments.

Thus, the fact remains that this legislation stands for placing greater burdens on interstate marketers in return for fewer benefits.

<u>In Lieu Provision of the Senate Bill is Only a Cosmetic Simplication</u>

Opponents of this legislation have long recognized that the burden issue is key and they have made some attempts to mitigate those burdens by relieving marketers and their customers of the responsibility of keeping track of the over 6,000 different local tax rates. That effort failed apparently because state governments could not devise a system for sharing their tax revenue with the local governments that would satisfy those local governments. What we are left with is a compromise between state and local governments which satisfies both those parties, but does not offer any tax simplifications to direct marketers. I am referring to the "in lieu" provision which is a part of the Senate bill introduced by Senator Dale Bumpers.

The "in lieu" provision offers direct marketers an alternative to collecting separate rates for thousands of different local jurisdictions. However, the marketers still would be required to collect every penny of local tax. The alternative is to charge a blended rate in every state that has multiple tax rates.

This would result in charging approximately half of a company's customers more tax than they actually owe (and the other half less), and charging all of them a tax rate that is different from the one they are used to paying.

There are a number of problems with the in lieu provision but the biggest one is that no direct marketer can afford to break trust with its customers by charging half of them more tax than they actually owe in order to reduce the company's collection costs. Thus, the industry would be back to square one and forced to collect according to the 6,000 plus different local rates. It should also be noted that the in lieu provision does not even attempt to address 50% of the complexity problems having to do with multiple filings, multiple audits, varying exemption schedules, etc., nor does it attempt to alleviate the mail order problem of check-paying customers having to calculate their own taxes.

Economic and Social Consequences of Federal Use Tax Legislation

The consequences of imposing high collection costs on this industry and introducing complexities into the ordering process would fall initially on direct marketing companies and their customers. Many marketers would be squeezed between higher costs and diminished sales. Some would go out of business. Some would sell out to larger companies. Particularly vulnerable would be those companies just above the threshold amount in the $20 - 50 million/year range with a high percentage of check-paying customers. Among the most vulnerable would be specialty catalogers with narrow markets. These catalogers would be sorely missed since they sell unique items not

available in stores. Those are the direct consequences. Some of the collateral consequences would be as follows:

1. **Fewer Jobs.** The catalog industry alone is responsible for a large boost to the national GDP, creating new economic activity by bringing thousands of new and different products within reach of millions of consumers. Direct marketing is responsible for over 5 million American jobs and is comprised of many small businesses (marketers and suppliers) ready to generate more jobs. Federal use tax legislation would greatly hamper the ability of the direct marketing industry to contribute to the GDP and would actually reduce employment in the industry.

2. **Less State Tax Revenue.** Ironically, this federal measure designed to enable states to collect more state sales tax revenue would cut into other sources of state revenue. It would cut into the taxable income and employment of direct marketing companies as well as the supplier industries such as transportation, printing, paper manufacturing, product manufacturing, list brokering, telemarketing, and other elements of the diverse direct marketing industry.

3. **Less Federal Tax Revenue.** Federal income tax revenue would be affected in the same way as state income tax revenue and federal receipts would be diminished even more since there would be no offsetting sales tax gain. In 1989, the big six accounting firm of Peat Marwick analyzed the impact that federal use tax legislation would have on federal tax receipts using the same methodology used by the Joint Committee in similar cases. The study concluded that federal receipts would be reduced by 20% of the state taxes collected. Over five years this would be between one and four billion dollars in lost federal taxes.

4. **Ceiling on Growth of Small Direct Marketing Businesses.** It has been universally recognized that any legislation in this area must have a di minimis threshold to shield truly small businesses from the impact of the legislation. But a threshold merely alters the problem. It does not solve it. Whatever the threshold it would act as a growth barrier for direct marketing businesses just at the point they are ready to contribute the most to the economy and job creation.

5. **Hardship for Millions of Consumers.** Of the hundred million consumers who purchase through direct marketing every year, a significant portion of them depend upon direct marketing for products which are necessary to their lifestyle. This includes handicapped and elderly consumers as well as those in rural areas. Many of the products that these groups depend upon will disappear from the marketplace if the burdens of federal use tax legislation are placed upon the hundreds of mid-size specialty catalogers. Consumers recognize this threat. In 1989 Congress received over half a million pieces of mail from mail order customers opposing federal legislation.

6. **Damaged to Unintended Targets.** The Bumpers bill would cover not only hundreds of catalog companies -- including many nonprofit organizations such as the Smithsonian, the Metropolitan Museum of Art, the National Wildlife Federation, American Medical Association, and the Disabled American Veterans -- but also a number of other large groups of national marketers. Among them are the following:

   - Book and magazine publishers and university presses.
   - Small manufacturing companies selling parts around the country to major U.S. corporations many of whom are our chief exporters.

- Other business-to-business marketers selling office supplies and specialty goods to educational institutions and governmental entities as well as private businesses. Many of these sales are tax exempt and some of the others are subject to a direct pay arrangement. Thus, very little additional tax would be collected. However, these hundreds of business-to business marketers would be required to obtain hundreds of thousands of tax exemption certificates and resale certificates from their customers, resulting in mounds of senseless paperwork and unproductive costs.

- Thousands of retailers. Any retail store that sells to tourists or customers who have goods sent to an out-of-state address would have to register and collect taxes for the destination states.

Tax Revenue Estimates Have Been Severely Inflated

The revenue estimates used by proponents of this legislation are much too high. They are based on a study done by the Advisory Commission on Intergovernmental Relations in 1984 and updated periodically using broad assumptions about the growth of the direct marketing industry. The ACIR study started with base sales figures for the direct marketing industry that were taken out of a magazine without consulting the compiler or the original studies. Nathan Associates performed a more careful study for DMA (executive summary attached) and used the same starting point as the ACIR, but worked with the compiler of the data to make sure that sales figures corrections were made for two large sales elements:

1. Tax exempt sales (billions of dollars of cable TV sales, stock purchases over the phone, mail order insurance sales, etc.) and

2. Sales for which the direct marketer was already collecting and remitting the tax (over 20 major direct marketers collecting in every state and 40 more collecting in more than 10 states -- the ACIR corrected only for Sears, JC Penney, and Montgomery Wards.

In a 1994 study, Nathan Associates concluded that the total amount of uncollected revenue from sales by companies over the threshold recommended by the ACIR ($12.5 million dollars in sales per year) was $1.38 billion for 1992. This figure represents the potential additional revenue for all states if every penny of revenue were collected at no cost to the governments, with no tax deductible cost to businesses, no decrease in sales volume, and no other collateral effects on the states' economy or revenue sources. In truth, the tax revenue gain would be considerable less and would produce great costs to society and to the economy.

Many Business and Consumer Groups Oppose Federal Use Tax Legislation

Because federal use tax legislation would have such widespread and serious consequences for businesses and consumers, there are many business and consumer groups who are strongly opposed. The 1992 U.S. Supreme Court case gave these groups a chance to demonstrate their opposition to the states' position. Seventeen national groups representing farmers, handicapped Americans, the elderly, etc., sponsored a brief to the Court explaining why a cumbersome tax collecting system for mail order products would be a particular threat to their memberships.

On the business side the National Association of Manufacturers sponsored a brief, joined by other business groups, opposing an extension of states' taxing authority because of the effect it would have on a large percentage of its over 15,000 members. Although not traditionally considered direct marketers, the typical NAM member is a small manufacturer with hundreds of thousands of customers nationwide and no tax responsibilities in any state but its home state. A change in the law would impose new and in many cases crushing burdens on small manufacturers. Lists of consumer and business groups opposed to the current legislation are among the attachments to this testimony.

Alternatives to Congressional Legislation are Available

In order to be at all feasible, federal legislation would have to attempt to standardize and simplify the current state and local tax system. However, even severe limitations on the power of states and local governments to impose inefficiencies and unproductive collection costs on national marketers would not entirely eliminate the problems. Fortunately, federal legislation is not necessary.

During 1991 and 1992, representatives of the Direct Marketing Association met periodically with representatives from the Multi-state Tax Commission and the Federation of Tax Administrators. After two years of discussions, hard negotiations, and many draft documents, the two teams left the bargaining table with a potential agreement to be presented to the state tax associations for ratification. The Voluntary Collection Agreement (VCA) would allow direct marketing companies to register with participating states voluntarily and collect taxes under vastly simplified and standardized procedures. In return these marketers would be free from the tax consequence of inadvertently entering a state with a taxable presence. For many large direct marketers the cost of avoiding these tax consequences was high enough that tax collecting under more reasonable procedures was attractive.

Thus, the additional revenue from larger direct marketers voluntarily collecting their states' taxes would serve as an incentive for these states to voluntarily give up some of the bells and whistles in their tax system to make it more compatible with the rules, regulations, exemptions, etc., of other states. A summary of the VCA conditions is contained in the attachments.

Despite its advantages, the VCA was not ratified by the state associations. The prospect of federal legislation may have influenced their decision since under the Bumpers bill states would not be required to do anything but cosmetic simplifications in

their tax systems. Nevertheless, the product of two years of work by the two negotiating teams remains as a possible blueprint for a resolution of this issue.

Another method of collecting the outstanding use tax revenue has been adopted by the State of Maine. A description of the Main alternative is among the attachments. In its first year Maine collected almost $2 million dollars in revenue. If that is representative of the potential of this method, it would be possible to collect over 20% of the outstanding revenue without any additional government costs or any burdens placed upon businesses or the economy.

Conclusion

The protection of national commerce was entrusted to Congress by the Founders for sound reasons born of experience with the Articles of Confederation. It is too easy for state and local governments to be blinded by urgent revenue needs and political pressures from local constituents. In this case the states' request for Congressional authority endangers their own economies as well as the viability of a large group of national marketers who have provided American business with the most efficient distribution system in the world (and thereby enhanced our competitiveness in the global market) and brought the wealth of the American market to the doorsteps of every American including large groups of consumers with no other access to these products.

Therefore, states should not be given what they think they want, but instead should be encouraged to ratify and implement a voluntary collection arrangement which has already been negotiated with the industry. Such a voluntary arrangement could achieve what federal legislation could never achieve -- a streamlining of America's state and local tax system for the benefit of all national marketers and additional revenue for state and local governments without damage to the economy or the services direct marketers provide to tens of million of consumers and hundreds of thousands of businesses.

NATHAN ASSOCIATES INC.
ECONOMIC AND MANAGEMENT CONSULTANTS

IMPACT OF TAXING INTERSTATE MAIL ORDER SALES ON STATE/LOCAL REVENUE

Findings Summary

Nathan Associates estimates that only $1,382 million in additional state and local government tax revenue could have been generated nationwide in 1991 if state governments had been permitted to require out-of-state mail order firms to collect use taxes. The revenue potential is only 0.19 percent of existing state and local revenue, excluding any federal grants and the revenues of states without a use tax on the state or local level. Figure 1 shows the potential use tax revenue would be a trivial component of state and local government revenues.

Thirty-seven percent of the potential nationwide revenue gain is accounted for by just five states: California, New York, Texas, Illinois, and Florida. Each of these states would potentially gain more than $70 million. Twenty-three states would each gain $16-65 million. The remaining states with a state or local use tax, including eighteen states and the District of Columbia, would account for only 11 percent of the potential nationwide gain and would each add less than $16 million to their state and local government revenues.

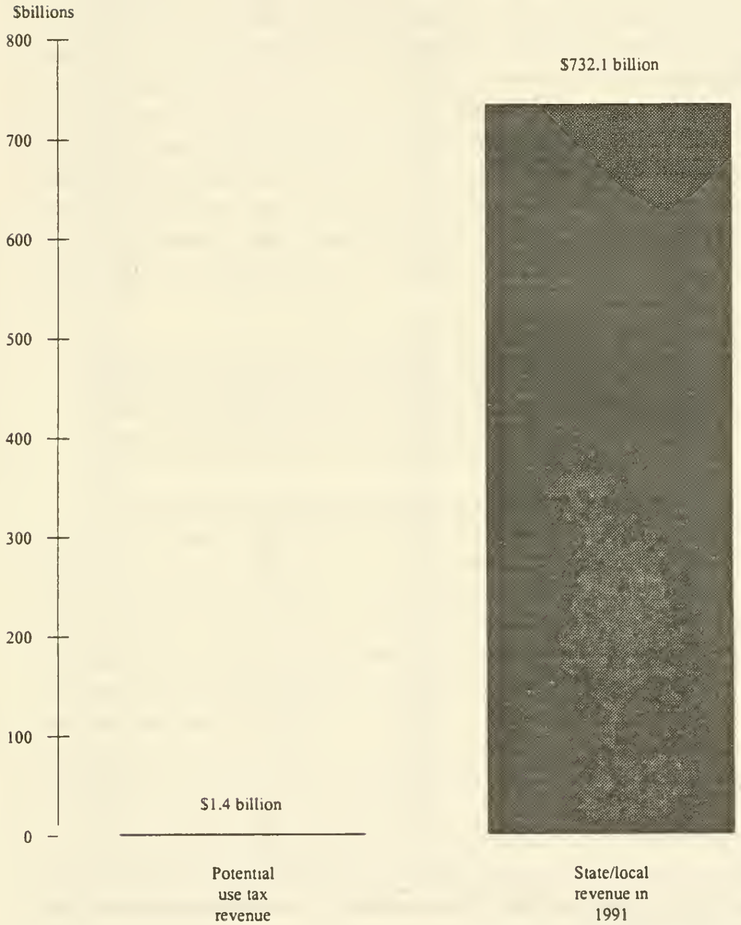
Methodology Summary

The starting point in evaluating the use tax revenue potential from interstate mail order sales was the nationwide mail order sales estimate in the annual *Guide to Mail Order Sales* by Arnold Fishman, President of Marketing Logistics, Inc. The nationwide sales volume was reduced to take out the sales of products and services that are tax exempt or on which taxes are already being collected. The sales of firms with annual sales of less than $10 million were also subtracted, since these firms would likely be excluded from any federal legislation permitting the taxation of interstate mail order sales. State and local sales tax rates were applied to the resulting sales base to estimate the revenue potential.

The estimate of the potential gain in use tax revenue is actually overstated to the extent that we were unable to quantify several reductions in the taxable mail order sales volume. For example, we could not measure the mail order sales to nonprofit and government entities that are tax exempt in many states. We also could not measure the sales on which business purchasers already pay use taxes to state and local government. In addition, we did not evaluate the adverse impact the taxation of interstate mail order sales would likely have on mail order sales and employment. The revenue potential would also be reduced by the costs of administering and enforcing the tax law and from some inadvertent noncompliance.

NATHAN ASSOCIATES INC.
ECONOMIC AND MANAGEMENT CONSULTANTS

Figure 1. Potential Use Tax Revenue Compared to State and Local Government Revenue in 1991



Note: The $732.1 billion in state and local government revenue in 1991 excludes federal grants and the revenue of states without a use tax on the state or local level. Including federal grants would make state/local revenue $882.5 billion and make the mail order use tax potential even more inconsequential in comparison.

Estimated Potential Use Tax Revenue in 1991 from Taxing Interstate Mail Order Sales ($millions)

State	State government	Local government	State and local government
Alabama	16.9	10.1	27.0
Alaska	--	2.6	2.6
Arizona	18.2	4.0	22.2
Arkansas	8.9	1.6	10.5
California	112.8	28.7	141.4
Colorado	11.3	11.9	23.3
Connecticut	19.9	--	19.9
District of Columbia	4.7	--	4.7
Florida	73.7	0.9	74.6
Georgia	23.0	7.3	30.3
Hawaii	6.0	--	6.0
Idaho	5.9	--	5.9
Illinois	57.6	17.4	75.0
Indiana	29.2	--	29.2
Iowa	11.3	0.3	11.6
Kansas	12.1	2.8	14.9
Kentucky	21.8	--	21.8
Louisiana	16.4	17.2	33.7
Maine	7.3	--	7.3
Maryland	31.1	--	31.1
Massachusetts	28.9	--	28.9
Michigan	36.6	--	36.6
Minnesota	21.1	0.2	21.2
Mississippi	13.5	0.6	14.1
Missouri	22.2	8.0	30.2
Nebraska	7.6	1.2	8.8
Nevada	8.7	0.1	8.7
New Jersey	54.0	--	54.0
New Mexico	8.5	1.8	10.4
New York	59.7	53.9	113.6
North Carolina	23.6	11.2	34.7
North Dakota	3.4	0.2	3.7
Ohio	44.6	7.4	52.1
Oklahoma	12.3	7.2	19.4
Pennsylvania	61.7	--	61.7
Rhode Island	7.6	--	7.6
South Carolina	16.9	--	16.9
South Dakota	3.2	1.2	4.4
Tennessee	27.5	8.6	36.1
Texas	88.5	19.2	107.7
Utah	8.2	1.8	9.9
Vermont	3.6	0.0	3.6
Virginia	20.6	6.5	27.0
Washington	38.3	5.5	43.8
West Virginia	10.5	--	10.5
Wisconsin	21.5	0.3	21.9
Wyoming	1.4	0.3	1.7
United States	1,142.4	239.8	1,382.2

Note: Delaware, Montana, New Hampshire, and Oregon do not have sales taxes on either the state or local level. Totals may not sum due to rounding.

Source: Nathan Associates Inc.

NATHAN ASSOCIATES INC.
ECONOMIC AND MANAGEMENT CONSULTANTS

RESPONSE TO A MISCHARACTERIZATION OF THE NATHAN METHODOLOGY IN THE ACIR REPORT

In *The Impact of Taxing Interstate Mail Order Sales on State/Local Government Revenue* (February 1994), a study prepared on behalf of the Direct Marketing Association, Nathan Associates estimated that only $1,382 million in additional state and local government tax revenue could have been generated nationwide in 1991 if state governments had been permitted to require out-of-state mail order firms to collect use taxes. An estimate of the revenue gain was also made by Professor Holley H. Ulbrich of Clemson University for the Advisory Commission on Intergovernmental Relations (ACIR) in the report *Taxation of Interstate Mail Order Sales 1994 Revenue Estimates* (May 1994). ACIR estimated a revenue gain of $3,302 million in 1994, a figure $1,920 million more than the estimate by Nathan Associates. ACIR's primary explanation for the lower Nathan Associates estimate was summarized in the following paragraph in its report.

> The basic differences between the two studies are not conceptual, but mathematical, in using multiplicative versus additive adjustments. We believe that the lower estimate of revenue potential in the Nathan Associates report is based on a mathematical difference. The results of successive subtractions (Nathan) is quite different from the result of successive multiplications (ACIR). The Nathan method fails to eliminate duplicate subtractions, thus underestimating the base and the revenue potential.

<u>This characterization of the Nathan methodology is incorrect</u>. As shown in the table on the next page that summarizes the Nathan methodology and results, no duplicate subtractions were made from the $162,050 million in U.S. mail order sales in 1991 to estimate the potential addition of $22,061 million to the use tax base; all the downward adjustments are additive. ACIR incorrectly believes each downward adjustment is predicated on the $162,050 million in U.S. mail order sales. In fact, each subtraction is based only on the mail order sales that remain in the base after any prior adjustments. In the second adjustment, for example, a subtraction was made for firms with annual sales below the *de minimis* threshold of $10 million. According to the *1987 Census of Retail Trade*, firms below the threshold account for 29.5 percent of mail order sales. The adjustment of $20,677 million was calculated as 29.5 percent of $70,093 (the base after the first adjustment), <u>not</u> 29.5 percent of $162,050 million (the base before any adjustments). In the same manner, the third adjustment of $1,047 million only reflects sales in states without a state or local use tax that are in the $49,416 million remaining in the base after the second adjustment. The same logic was followed in the other adjustments to derive the potential additional use tax base of $22,061 million.

August 31, 1994

NATHAN ASSOCIATES INC.
ECONOMIC AND MANAGEMENT CONSULTANTS

Summary of Methodology and Results

		Millions of dollars
U.S. mail order sales in 1991		162,050
Downward adjustments		
Adjustment 1:	Products or services that are nationally tax exempt or for which taxes are already being collected nationwide	-91,957
	Base after adjustment 1	70,093
Adjustment 2:	Sales of firms with annual revenue of less than $10 million in the remaining base of $70,093 million	-20,677
	Base after adjustment 2	49,416
Adjustment 3:	Sales in states without a state or local use tax in the remaining base of $49,416 million	-1,047
	Base after adjustment 3	48,369
Adjustment 4:	State-specific nexus adjustments for the remaining base of $48,369 million	-23,683
	Base after adjustment 4	24,686
Adjustment 5:	State-specific exemptions adjustment for the remaining base of $24,686 million	-2,625
Potential additional use tax base		22,061
Combined state/local use tax rate		6.265%
Potential additional use tax revenue in 1991		1,382

FEDERAL REVENUE IMPACT OF OVERRIDING THE <u>BELLAS HESS</u> DECISION

Prepared by

The Policy Economics Group

of Peat Marwick Main and Co.

January 1988

EXECUTIVE SUMMARY

Legislation is currently under active consideration by Congress that would require direct marketers to collect sales taxes in states where they have no presence. Such proposals have revenue implications for the direct marketers, for state and local governments, and for the Federal government. This study has focused on an examination of the revenue impact of these legislative initiatives on revenues at the Federal level.

State Sales Taxes and Federal Revenues

The focus of this report is on the linkage between state taxes and Federal revenues. Forecasting models used for predicting the Federal revenue impact of Congressional legislation, including those used by the Joint Committee on Taxation, contain a Federal income tax offset for excise tax changes. This income tax offset is due to the special role played by excise, or sales, taxes. An excise tax represents a wedge between the price paid by the buyer and the revenue received by the seller. This wedge reduces factor income which, in turn, erodes the Federal income tax base.

Baseline Assumptions

Estimates of the Federal impacts of the proposed extension of sales tax collection activities are sensitive to certain assumptions at the state level. In particular, these Federal effects are dependent on two key baseline assumptions:

- The estimated size of the potential increase in sales tax collections by states, and;

- The response by states in terms of the extent to which they will choose to retain these additional receipts for increased expenditures, or return them to the taxpayer in the form of a tax reduction.

Previous studies by the Advisory Commission on Intergovernmental Relations (ACIR) and Robert R. Nathan Associates, Inc. (RRNA) estimated the increase in state sales tax revenues. Both estimates have been used, in this report, as baselines for the Federal revenue estimates in this report. The updated ACIR study estimated that, in 1985, the potential additional sales tax revenues would amount to approximately $1.2 billion, while the RRNA study projected revenues of $0.7 billion using 1984 as the base year.

Using these two state revenue estimates as baselines, the analysis examines the Federal revenue effects of the proposed legislation under four different scenarios concerning the responses by states to an increase in sales tax revenues. These scenarios assume that states would:

(1) Retain all additional revenues and increase expenditures accordingly;

(2) Return a portion of the revenues in the form of reduced sales taxes;

(3) Return a portion of the revenues such that the existing ratio of income taxes to sales taxes is maintained, or;

(4) Return all of the additional revenues in the form of sales tax reductions.

Estimated Federal Revenue Losses

Exhibit 1 below presents a summary of the estimated Federal revenue impact for the two baseline estimates using the ACIR and the RRNA projections of potential sales tax receipts. These estimates range from losses of $0.3 to $2.2 billion over the period from fiscal year 1988 to 1992.

Exhibit 1
Five-Year Estimated Federal Revenue Effect, FY 1988-92
(Dollars in Billions)

	State Response			
	(1) No Change	(2) Partial Sales Tax Reduction	(3) Partial Sales & Income Tax Reduction	(4) Full Sales Tax Reduction
Baseline				
ACIR	$-2.2	-1.0	-1.4	-0.4
RRNA	-1.4	-0.6	-0.9	-0.3

The actual Federal revenue impact of the legislative proposals currently under consideration is likely to fall somewhere in this range. Based on the available literature and historical experience with state revenue windfalls, there will be some response on the part of states to return a significant portion of the increased receipts through tax reductions,[1/] but to retain a small portion

1/ In this case it is unlikely that the tax reductions would be in the form of sales tax rate reductions since the proposed additional sales tax revenues represent such a small percentage of the general sales tax base. Using the larger ACIR estimates, the additional sales taxes represent an overall increase of only 1.4 percent over the existing state and local general sales and gross receipts tax base. If all of these additional revenues would be returned in the form of reduced sales tax rates, rates would have to be reduced by this same 1.4 percent. A sales tax rate of 5 percent, for example, would have to be reduced by an unrealistically small amount, from 5 percent to 4.93 percent. Partial sales tax reduction would yield even smaller rate changes.

to support increased expenditures. Therefore, options 2 and 3 shown in the Exhibit represent the most likely scenarios. Depending on the baseline revenue estimate used, the resulting Federal revenue impact would range from losses of $0.6 billion to $1.4 billion over the five year period.

Regardless of the underlying assumptions employed, however, the legislative proposals to expand the collection of state sales taxes through direct marketers would result in a net revenue loss to the Federal government.

Touche Ross

A STUDY TO DETERMINE THE ECONOMIC IMPACT
ON MAIL ORDER FIRMS OF
MULTI-STATE SALES TAX COLLECTION

PREPARED FOR THE
DIRECT MARKETING ASSOCIATION

EXECUTIVE SUMMARY

OCTOBER 1986

EXECUTIVE SUMMARY

Background Information

Currently, direct marketing firms are required to collect sales taxes in the states where they have nexus (presence). This process involves collection, recordkeeping and submission of the tax on behalf of the states for which they are collecting. Legislation is currently being proposed that would require direct marketing firms to collect sales taxes in jurisdictions (maximum 46) in addition to those in which they have nexus and are currently collecting.

As a result, the DMA determined that a study should be undertaken to objectively analyze the costs of collecting sales tax and to make estimates as to the impact of the proposed legislation. After this determination, the DMA engaged Touche Ross to perform various analyses primarily through detailed on-site visits in order to establish a factual data base for evaluations.

Study Methodology

Throughout our study, we had these objectives:

- Survey a representative sample of direct marketing firms in various parts of the country
- Identify and document the costs incurred by the firms due to collecting, processing and remitting state sales taxes
- Develop an accurate and detailed data base of sales tax collection costs of the firms surveyed
- Assess the potential compliance cost impact on the firms if the number of collecting jurisdictions were to be expanded.

Approach to the Study

In order to achieve the above results and to ensure that the results are credible and defensible, we selected a sample of firms:

- Of various sizes
- Selling various types of merchandise
- Both high and low cost items
- Various geographic locations
- With various degrees of nexus.

Survey Sample

Those firms selected to be included in the survey were selected from membership lists provided by the Direct Marketing Association (DMA). In addition, respondents were also selected from lists obtained from the DMA of non-member mail order firms.

In all, 30 on-site surveys were completed. On-site respondents were of multiple types and sizes with the majority being located in the northeast and midwest. Detailed response information appears under the section "Findings from the Surveys."

All firms not selected for the on-site survey and having annual sales of at least $3 million were sent mail order questionnaires. Of the 400 mail surveys sent, 108 were received, of which 82 were in usable form (a 27% response rate).

On-Site Questionnaire Analysis

For each of the 30 firms included in the on-site survey, we performed an analysis of the cost for that firm to collect sales tax. A typical analysis is presented in Appendix C of this report. The costs are summarized into the following categories:

- Employee cost
- Administration cost
- Transaction and training cost
- Data processing cost
- Fees and bad debts
- Absorbed cost
- Use of proceeds

A brief description of each category is shown below:

- Employee Cost - The cost of processing, recording, depositing, reporting and remitting sales tax. Additional costs could include interfacing with state sales tax auditors, following up with customers refusing or questioning the payment of sales tax, and the maintenance of sales tax exemption files

- Administration Cost - The cost attributable to sales tax collection, including ongoing computer time, legal fees, audit fees, sales tax literature, or other miscellaneous non-labor-type costs

- Transaction and Training Costs - The costs (where applicable) of manually identifying an order as taxable, computing the tax and recording the transaction. Also included were any costs associated with manual operations used in conjunction with an automatic system, such as extra keystrokes, exception reporting, and exemption certificate matching. Personnel training costs were also included

- Data Processing Cost - The portion of software amortization associated with any automatic sales tax processing and any other computer costs such as the cost of a microcomputer used for sales tax analysis. These costs were capital costs, not ongoing costs

- Fees and Bad Debts - The cost of remitting sales tax monies to the states which the firm did not collect from customers, such as credit card fees on sales charged to bank cards, bad checks or bad debts

- Absorbed Tax Cost - This cost represents the difference between what a firm collects from its customers and what it remits to the states. There are two types of absorbed cost: 1) where the company charges the tax to the customer, but the customer does not remit sales tax or sends too small an amount; 2) where the firm has a policy not to collect sales tax from its customers but pays the states out of internal operating funds. Two firms in the on-site survey have a policy of not collecting sales tax from customers. This absorbed tax (cost) amounted to $32,500 out of total net collection cost for all 30 companies of $1,600,000. We have identified this amount separately and excluded it from the tables for the following reasons:

  . The two firms both stated they would collect the tax if the law is changed to include 46 jurisdictions, whether the firm has nexus or not

  . The overall impact is small:

    .. $32,500/$1,600,000 = 2.0%

    .. net collection cost rises from 3.58% of taxes payable to 3.65% on a weighted average

- Use of Proceeds - These revenues represent the interest earned or interest avoided by firms through the use of sales tax monies from the time of collection to the time of remittance to the state.

At the conclusion of each on-site survey, we computed the cost by category for each firm, and then computed the total cost of collecting tax; all costs expressed as a percent of tax paid. The next section presents highlights of our findings.

The findings and conclusions are based on the methodology detailed in this report and the data provided by the firms surveyed. The data supplied to us was produced in the normal course of the companies' operations, or was derived therefrom. Although we tested

the data supplied to us for reasonableness, we did not audit the financial or statistical records from which the data was extracted for the purposes of this report. Accordingly, we cannot and do not express any opinion on the accuracy of those records.

Summary and Conclusions of the Surveys

Based on the data collected from the on-site surveys, and verified by the mail surveys, we found that a high majority of firms experienced large uncompensated costs in collecting sales tax and that certain factors contributed to high sales tax costs as a percentage of tax paid.

On-site Survey

- Overall net costs

  Overall net costs for the 30 firms participating in the detailed on-site survey averaged 3.58% on a weighted average basis and 15.09% on a simple average basis after reducing the costs for the use of proceeds. Costs are presented throughout the report on a weighted and simple average basis.

Net Sales Tax Costs as a Percent of Taxes Payable

	Weighted Average	Simple Average
Number of firms	30	30
Employee costs	.73%	6.19%
Administrative costs	.66	3.37
Transaction/training cost	.03	2.31
Data processing costs	.07	.98
Fees/bad debt costs	1.41	1.91
Absorbed costs	.61	.96
Gross collection costs	3.51	15.72
Less: use of proceeds	- 0.07	.63
Net collection costs	3.58	15.09
Less: commissions/discounts	.90	.99
Uncompensated costs	2.68%	14.10%

The large difference between the two cost percentages (3.58% and 15.09%) can be attributed to the extremely large firms having very low collection costs (shown below under "Size of the firm"). These firms impact the weighted average percent downward significantly.

The distribution of the firms is shown below:

Sales Tax Costs as a Percentage of Sales Tax Paid	Number of Firms
Less than 1%	2
1% to 5%	6
5% to 10%	6
10% to 20%	8
20% to 50%	7
Greater than 50%	1
Total	30

As shown, over half the firms in the survey incurred costs of collection in excess of 10%.

- Key Factors Affecting Sales Tax Costs

During the course of our analysis, we identified key factors that significantly influenced the sales tax collection costs as a percentage of tax paid for the on-site firms.

- Size of the firm - firms with higher gross sales tend to have lower sales tax costs as a percentage of tax paid, because certain costs are "fixed." For example, doubling the volume of taxable sales does not double the amount of time required to complete the various sales tax returns, particularly if the firm already was filing returns in that particular state.

Size of Firm in Annual Gross Sales	Sales Tax Costs as a Percentage of Tax Paid: Weighted Average	Simple Average
Less than $10 million	13.9%	25.1%
$10 to $25 million	12.7	15.6
$25 to $50 million	12.1	12.2
$50 to $100 million	3.4	6.2
Greater than $100 million	2.8	2.4

Table 1 on the following page shows the detailed analysis by cost element.

Other analyses which we made (for example, of the number of transactions processed) confirmed that size is the key factor in determining sales tax costs as a percentage of tax paid.

TABLE 1: COST OF COLLECTION BY SIZE OF FIRM (GROSS SALES)
(Showing Sales Tax Cost as a Percent of Taxes Payable)

Costs by Sales (Weighted Average)	<10MM	10-25MM	25-50MM	50-100M	>100M	Total
Firms	9	7	7	4	3	30
Employee	6.03%	2.88%	1.83%	1.65%	.40%	.73%
Administration	4.69	.85	2.20	1.16	.46	.66
Transaction	.98	.26	.01	.05	.00	.03
Data Processing	1.04	.75	.62	.01	.02	.07
Fees/Bad Debts	1.07	1.50	6.71	.88	1.29	1.41
Absorbed Costs	.14	6.73	.69	.41	.42	.61
Gross Collection Costs	13.95	12.97	12.06	4.16	2.59	3.51
Use of Proceeds	.09	.29	-.01	.76	-.17	-.07
Net Collection Costs	13.86	12.68	12.07	3.40	2.76	3.58
Less: Commissions/Penalties	.73	.42	.59	1.07	.91	.90
Uncompensated Cost of Collection	13.13%	12.26%	11.48%	2.33%	1.85%	2.68%
Costs by Sales (Simple Average)						
Firms	9	7	7	4	3	30
Employee	12.25%	4.57%	5.02%	1.82%	.38%	6.19%
Administration	5.90	2.47	3.51	1.16	.46	3.37
Transaction	4.24	4.34	.04	.13	.00	2.31
Data Processing	1.39	1.35	1.04	.01	.02	.98
Fees/Bad Debts	1.84	1.05	3.26	1.80	1.10	1.91
Absorbed Costs	.36	2.27	.44	1.40	.34	.96
Gross Collection Costs	25.98	16.05	13.31	6.32	2.30	15.72
Less: use of proceeds	.84	.46	1.12	.16	-.14	.63
Net Collection Costs	25.14	15.59	12.19	6.16	2.44	15.09
Less: commissions/penalties	.74	.95	.98	1.52	1.10	.99
Uncompensated Cost of Collection	24.40%	14.64%	11.21%	4.64%	1.34%	14.10%

Large size allows a company to invest in certain fixed costs (e.g., sophisticated automated systems). These costs are spread over more sales tax paid, so that cost as a percentage of sales tax paid decreases. To the extent the company takes advantage of these investments, its percentage will be lower.

- Type of merchandise sold - sales tax costs varied significantly by type of mail order firm, because the firms have different characteristics that impact costs. In general, these characteristics are the same as identified above: gross sales, taxable sales percentage, tax paid and number of transactions

	Sales Tax Costs as a Percentage of Tax Paid	
Merchandise Type	Weighted Average	Simple Average
Apparel	8.1%	10.3%
Food	17.3	20.2
Books/records/magazines	4.2	20.8
General merchandise	2.2	2.6
Gifts	10.7	16.8
Collectible	16.7	15.2
Other	9.0	15.0

The Mail Survey

Results of the mail survey were used to provide limited cost analysis and additional support for the on-site surveys. The mail surveys showed that characteristics contained in the on-site survey also existed in the larger mail survey. The mail survey findings indicated that the net cost of collecting sales tax was 10.05% on a weighted average basis and 38.74% on a simple average basis. Mail survey cost components were about three to four times higher than the same on-site components; however, these could not be verified in the same detail as the on-site costs were. These components did account for about the same proportion of gross collection cost as in the on-site, thus verifying the relative magnitude of the on-site findings.

Other Findings

- Generally, surveyed firms are highly automated, thus reducing, on a percent of sales basis, the transaction and training costs significantly. Those firms which are in part manually processing sales tax transactions had the highest overall cost percent.

- Firms which pay large amounts of tax to the states generally are required to pay sales taxes weekly based on last year's tax paid. Thus, their benefit from use of the sales tax monies may be nonexistent or negative, particularly if they are on an accounts receivable system with a high average number of days outstanding balance.

- Of the on-site respondents and mail respondents, 6.7% and 3.7%, respectively, do not collect sales tax from customers: they pay the tax due totally out of internal funds. The reason varies, but generally they feel that the cost of administering the tax far outweighs the actual cost of the tax, and from a cost standpoint they are better off absorbing the tax internally.

- Many on-site respondents were burdened by the tracking of exempt products or customers. One respondent manually checks each order against exemption files: this amounts to over 12,000 orders per year.

Future Implications for Incremental Costs

During the on-site interviews, all firms were asked to estimate the cost of collecting the sales tax if the legislation were passed. Specifically, companies were asked to estimate the cost of collecting sales tax on taxable sales in all states. When asked to determine where the greatest cost impact would be, the following topics were mentioned:

One Time Costs

- Systems Development - all firms surveyed had automated systems to some degree, although several were still highly dependent on manual systems. The firms were asked to describe or estimate the development effort to meet the requirements of the new legislation. Those already collecting tax in multiple states felt that the impact to them would be minimal as they already have systems in place for multi-state sales tax collection. Those firms currently collecting tax in only a few states feel that they would incur substantial costs in the development of systems to handle the new requirements. In fact many of the firms interviewed did not presently have a reporting mechanism to report sales by state.

  Many of these firms are small- to medium-sized and in general have a small internal data processing staff. Therefore, they would be forced to hire more staff or use outside software development firms. Either alternative would result in substantial costs to the firm to satisfy proposed legislative requirements.

  In addition to software development costs, the additional information requirements for sales tax reporting would increase the amount of system memory required to process the tax information. For some firms, the purchase of additional main and auxiliary computer memory would be required.

- Tax-exempt Information Cost - if the proposed legislation were passed, firms would incur costs in collecting tax-exempt information by product for each state. This information would either have to be entered into the computer system (if automated) or be prepared for manual look-up. In addition, procedures would have to be established and documented through procedures manuals

- Printing Costs - all firms would be forced to include sales tax tables in their respective catalogs, either increasing the cost or reducing the amount of space that can be provided for products.

<u>Ongoing Costs</u>

As described earlier, the costs of collecting sales tax would increase significantly under the proposed legislation.

- All types of cost would increase to handle the increased number of jurisdictions:

  . Employee
  . Administration
  . Transaction/Training
  . Data Processing
  . Fees/Bad Debts
  . Absorbed Tax

- Absorbed Tax/Lost Sales - several firms were concerned that many customers would refuse to do business with the firm if they were charged sales tax. All firms contacted during the on-site survey accept orders even if the customer refuses to pay tax, the tax being absorbed by the firm as a cost of retaining the customer. Few firms had hard estimates as to the true cost of this absorption as most of the sales systems treat this as a reduction of sales price and the sales tax portion could not be separately identified. Therefore current costs reported in this study are understated by that amount.

  This cost would increase dramatically under the new legislation. Several firms interviewed during the on-site survey did not collect tax from their customers but simply paid the tax to the states out of operating funds. In general, the firms felt that the cost of absorbing the tax was less burdensome than the cost of calculating, reporting and remitting the tax.

  These firms would incur significantly higher costs than the other firms in developing systems, training personnel, determining procedures and educating customers.

- Employee (Sales Tax Audits) - 50% of the on-site and 72% of the mail survey respondents were audited by states' sales tax auditors at least once during the last three years (many have been audited multiple times). The legislation, if passed, would subject the firms to multiple sales tax audits from the states in which they collect tax.

  These audits are costly in terms of the data collection cost incurred to prepare for the audits and consume large amounts of executive time in producing information, and interfacing with the sales tax auditors. This burden is increased in the opinion of several executives by the relative lack of sophistication on the part of many sales tax auditors. These auditors must be instructed on many basic aspects of the direct marketing business during the course of their audits.

  Also, for the first time, firms would be facing audits from states where they have little or no business presence and have limited ability to contest the findings or the applicability of the audits.

  Of particular concern to many of the executives is their firm's lack of expertise in the sales tax laws of the various jurisdictions. The lack of standardization of rates, exempt products, return due dates, and regulations would impose large burdens on these firms in learning the laws of the various jurisdictions.

Summary

The impact of passing the proposed legislation to impose use taxes on out of state mail order sales where a firm does not have nexus would be significant in the following areas:

- Substantial increase in the cost of collecting use taxes from the customer, since many mail order firms would be required to collect for additional taxing jurisdictions.

  Current costs as a percent of tax collected are as follows:

  . Overall weighted average costs are 3.58% for the participants in the on-site survey and 10.05% for the participants in the mail survey.

  . Overall simple average costs are 15.09% for the participants in the on-site survey and 38.74% for the mail survey participants.

  Associated costs would be incurred for sales not currently requiring tax collection.

- Significant one-time startup costs for systems and procedures development, affecting firms not already collecting in multiple states, as would be required by the legislation.

- Investment in in-house personnel to keep current with the legislative changes in multiple jurisdictions and associated tax rate table changes and exempt product updates or additional ongoing systems development required to capture and transmit the required information to each jurisdiction.

Additional Information

Additional information describing the approach, methodology, and detailed findings of this study of sales tax collection costs is contained in the complete study.

A Voluntary Collection Agreement was negotiated in 1991 and 1992 by negotiating teams for the direct marketing industry and state revenue officials. Negotiators representing the state officials included members of the Federation of Tax Administrators and the Multistate Tax Commission. Unfortunately, in December, 1992 the executive committees for the FTA and MTC refused to approve the negotiated agreement, expressing their preference to press for federal legislation.

According to the agreement negotiated and submitted to the MTC and FTA Executive Committees in December of 1992, qualified direct marketers (QDMs) would be eligible to register and collect taxes in participating states under the simplified rules and procedures outlined below. "A Qualified Direct Marketer" is defined precisely in the agreement, but generally includes companies that lack a clear marketing presence (people or property or agents) in the taxing state. QDMs that meet these qualifying conditions for prior years would also be exempt from potential back tax liabilities in those states.

The key elements of the simplified collection procedures:

1. A QDM would be able to collect a single unified rate in each of the participating states, thereby reducing the number of tax rates from over 6,000 to 46. The single rate in each state would be the lowest applicable rate, so that no customer would be required to pay more tax than he or she actually owed.

2. A QDM would not be held liable for taxes that were not paid by customers who failed to include the tax in check payments where a good faith effort was made to collect them.

3. QDMs would have the benefit of a number of standardizations to be developed by the states: uniform definitions of exempt items, standard treatment of gifts, a standard remittance form and joint audits (instead of multiple audits by individual participating states).

The text of the agreement is attached.

VOLUNTARY TAX COLLECTION AGREEMENT BETWEEN (*STATE DEPARTMENT OF REVENUE*) AND DIRECT MARKETER

INTRODUCTION

This Agreement is entered between the (*State Department of Revenue*), hereinafter referred to as the "Department", and (*mail order retailer*), hereinafter referred to as the "Direct Marketer". It provides for the collection of state use taxes by Direct Marketer on a voluntary basis, without the acknowledgement by the Direct Marketer of any legal obligation to collect such taxes. In return for Direct Marketer's agreement to collect state use taxes, the Department agrees to permit such collection on a simplified basis and to coordinate its tax collection procedures for qualified direct marketers with those of other states providing similar voluntary use tax collection arrangements.

The Department and Direct Marketer acknowledge that, based upon the representations made by the Direct Marketer, Direct Marketer is a "qualified direct marketer" as that term is defined in the INTERSTATE AGREEMENT ON VOLUNTARY MULTISTATE COLLECTION OF SALES AND USE TAXES, hereinafter to referred as the "Interstate Agreement ".

Section 1 - REGISTRATION

Direct Marketer agrees to file with the Department a Standard Interstate Agreement Registration Statement and to commence collection of use taxes pursuant to this Agreement effective ______________________, 1993. The Department shall not require the filing of any additional forms, bonds or other documents as a condition to Direct Marketer's collection of use taxes pursuant to this Agreement.

Section 2 - UNIFORM STATE USE TAX RATE

A. For the purpose of this Agreement alone, the Department shall establish a single, unified state and local use tax rate, hereinafter referred to as the "Uniform Rate". The Uniform Rate shall be no greater than the combined state and local use tax rate (if any) in any geographic location within the state. Nothing in this Section shall restrict either the state or its political subdivisions from adjusting their use tax rates during the term of this Agreement.

B. The Direct Marketer shall not be required to state separately the amount of tax or the Uniform Rate in its advertising materials. At its option, the Direct Marketer may advertise prices as including applicable taxes (e.g., "tax included"). Notwithstanding the above, if the Direct Marketer does not disclose to its customers the amount or rate of tax due on their purchases, the Direct Marketer shall, nonetheless, be responsible for remitting the correct amount of tax to the Department based upon the gross sales price net of taxes, a record of which prices shall be maintained by Direct Marketer.

Section 3 - UNCOLLECTED TAXES

The Department shall not hold the Direct Marketer directly liable or otherwise responsible for remittance of use taxes in regard to sales transactions where purchasers have failed to remit the proper tax amounts with their payments, even though use taxes remain due from such purchasers, if either of the following conditions exist:

Condition 1:

a) The obligation to pay the tax was clearly indicated on the order form; and

b) If the tax due from the purchaser in connection with a sales transaction was greater than ten dollars, a reminder notice was sent to the purchaser ; and

c) Within thirty (30) days of the end of any calendar quarter, the Direct Marketer turns over to the Department relevant transaction data regarding those purchasers whose tax liability for that quarter is greater than ten (10) dollars and who did not remit the applicable use tax with their payments.

Condition 2:

Within thirty (30) days of the end of any calendar quarter, the Direct Marketer certifies that the outstanding uncollected tax is less than ten percent (10%) of the total tax due for sales during that quarter.

Section 4 - ADMINISTRATIVE PROCEDURES

A. Within thirty (30) days of the end of each calendar quarter, the Direct Marketer shall report to the Department, on the Standard Interstate Agreement Remittance Form, all sales subject to taxation, along with the amount of taxes actually collected, and shall remit such taxes to the Department with its report.

B. The Department shall not independently audit Direct Marketer. Audits of the Direct Marketer shall be conducted on a joint basis with the other Party states by the state, its

representative, state instrumentality or other entity designated pursuant to the Interstate Agreement , and such audits shall not be conducted more frequently than once per year.

C. No information received by the Department through reports or certifications of the Direct Marketer or through audits of the Direct Marketer may be used by the Department for any purpose other than its collection of taxes pursuant to this Agreement.

Section 5 - STANDARDIZATION

A. Except as may be authorized by law, no use tax shall be imposed on Direct Marketer's charges to its purchasers for shipping and handling.

B. A use tax on gift transactions (e.g., transactions in which the recipient of the goods does not pay any consideration for the goods) shall be due to the Department only if the billing address of Direct Marketer's purchaser (i.e., the person paying for the goods and making the gift) is located within the State of ________. Neither the Direct Marketer nor the recipient of the goods within the State of _______ shall be liable for any payment of use tax on goods purchased by persons whose billing address is located outside the State of _________ and who directed the delivery of the gifted goods to persons located within the State of ________.

C. Sales for resale shall not be subject to use tax. The Direct Marketer shall not be required to obtain a resale certificate to establish proof of a sale for resale. Any evidence, including but not limited to, a resale certificate

number, an affidavit, an unsworn written statement, or proof that the purchaser is engaged in reselling similar products to those purchased from Direct Marketer in the usual course of its business shall constitute sufficient evidence of a sale for resale.

D. The Department agrees to apply to transactions by the Direct Marketer the uniform definitions of commonly exempted products, such as food and clothing, developed pursuant to the Interstate Agreement , to the extent that such products are exempt from use tax under the laws administered by the Department.

E. In regard to the use tax on installment sales and series sales of products, the computation and due date for such taxes shall be based upon the periodic payments by customers.

Section 6 - IMMUNITIES

A. During the term of this Agreement, the Direct Marketer shall not be liable for any state use tax collection, reporting or remittance obligations to the Department beyond those specifically set forth in this Agreement.

B. Any resident of the State of ____________________ who pays the full amount of state use tax to Direct Marketer as required under this Agreement shall be relieved of any further use tax liabilities in connection with the same sales transaction.

C. The Department shall waive any claim of liability against the Direct Marketer for uncollected state use taxes for the period prior to the effective date of this Agreement.

D. Neither this Agreement, nor the Interstate Agreement, nor any acts or conduct undertaken taken pursuant to said Agreements, shall constitute a waiver of any rights or defenses of either the Direct Marketer, the State of ________________, or any other person or entity not a party to those agreements, except as expressly set forth in this Agreement; nor shall they constitute evidence of or acknowledgement of any jurisdictional or regulatory authority, or any lack thereof, of the Department or any other agency of state government either during or after the term of this Agreement.

Section 7 - LIMITATION OF LIABILITY.

Notwithstanding any other provision contained in this Agreement to the contrary, should Direct Marketer's prior activities in this state exceed that described in Article III.2.d. or III.3.d. as set forth in the Interstate Agreement, the Department may seek by assessment or other lawful procedure the collection of state and local use taxes for a period not to exceed two years preceding the date that the Direct Marketer has registered to collect use taxes for this state under this Agreement, so long as this state commences an audit of the Direct Marketer for such liability within eight months (240 days) from the date of such registration. With the exception of this potential liability, Direct Marketer shall be treated for all other purposes as a qualified Direct Marketer as that term is defined in the Interstate Agreement.

Section 8 - DURATION AND TERMINATION

A. This Agreement shall remain in effect and binding on

both parties for a period of five (5) years from date of the Direct Marketer's registration to collect this state's use taxes and shall not be impaired or otherwise affected by subsequent state or federal legislation. The immunities provided by this Agreement shall survive its termination.

B. This Agreement shall automatically be renewed for successive terms of five years each, unless either party provides notice of termination to the other party at least twelve months prior to the expiration of the initial or any subsequent term of this Agreement. Such notice of termination shall be sent by certified mail, return receipt requested. Notice to the Department shall be addressed to the Commissioner or Director of Taxation, as the case may be; and notice to the Direct Marketer shall be addressed to its president.

This Agreement has been executed as of the dates set forth below by the Party state and the Direct Marketer.

State of ________________________________

By: ________________________________

Title: ________________________________

Date: ________________________________

Direct Marketer: ____________________________________

By: ______________________________

Title: ______________________________

Date: ______________________________

DIRECT MARKETING ASSOCIATION, INC.
1101 17th Street NW Washington, DC 20036-4704 • (202) 347-1222 Fax (202) 785-2231

ROBERT J. LEVERING, ESQ.
SENIOR VICE PRESIDENT, CATALOG ISSUES

December 9, 1992

VIA FACSIMILE

Harley Duncan
Executive Director
National Federation of
Tax Administrators
444 North Capitol Street, N.W.
Suite 334
Washington, D.C. 20001

Dan Bucks
Executive Director
Multistate Tax Commission
444 North Capitol Street, N.W.
Suite 409
Washington, D.C. 20001

Dear Harley and Dan:

This letter is in response to your request for information concerning the anticipated level of participation by direct marketers in a Voluntary Tax Collection Agreement should such an agreement be offered by the states. You requested this information by December 9 so that it could be presented to the FTA and MTC Executive Committee meetings on the 10th and assist those committees in evaluating the draft agreement.

The negotiating teams have made substantial progress in reaching a point where a voluntary tax collection agreement is at least a possibility. The draft agreement coming out of our last session on November 30 represents a number of substantial compromises by both sides. We appreciate the effort which has been made and the good faith which has been demonstrated between industry and government officials in these negotiations.

I understand the need of your organizations, as part of their evaluation of the draft agreement, for a firm estimate on the level of industry participation and volume of sales which are likely to fall under a voluntary use tax collection program. The numbers set forth later in this letter are the result of substantial polling of, and discussions with, direct marketers since our November 30 meeting. Obviously, this is a short period of time within which to obtain responses from a large and diverse industry in regard to a long and complicated agreement.

Headquarters:
11 West 42nd Street
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• President • Conference Administration • Conference Programming • Councils • Professional Training & Development • Seminar Center • Public Relations • Information Central • Library • Market Development • International Services

6 East 43rd Street
New York, NY 10017-4646
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• Membership Development • Conference Registration • ECHO • Industry Relations • Research • Publication Sales • Information Systems • Personnel • Promotion/Production • Finance • Direct Marketing Educational Foundation

1101 17th Street NW
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• Government Affairs
• Ethics & Consumer Affairs
• Conference Logistics

Nonetheless, I believe that the figures are "hard" and will present to your respective memberships a realistic view of the potential of the draft Interstate Agreement.

As you know, to our disappointment, the states in these negotiations did not begin to approach the original proposal of the Direct Marketing Association for a single, unified, national mail order use tax rate and a single entity to which taxes would be reported and remitted. Nor did we obtain important objectives regarding such matters as standardized treatment of shipping and handling charges and uniform definitions for commonly exempted products and transactions (as compared to a promise to provide such uniformity sometime in the future). DMA agreed to compromise on these matters in the belief that a sufficient number of large direct marketers would still find the agreement attractive. However, there is no question that these departures from a more standardized and simplified model will limit direct marketer participation in the program.

Also, the numbers set forth in this letter assume that all states with sales and use tax laws will join the Interstate Agreement. Indeed, in requesting estimates from the DMA, you informed us that such universal participation by the states should be the operative basis for our estimates -- even though it was unlikely that such a participation level would be reached among the states. The disparity in state tax laws has long been the principal objection of direct marketers. Consequently, if the number of participating states falls substantially short of universal participation, we can expect a decline in participation by direct marketers. Obviously, this is a matter totally within the control of the states and neither the Direct Marketing Association nor its member have any say in that decision.

Based on discussions with company executives representing all of the major segments of the direct marketing industry, I anticipate the following level of participation in the Voluntary Tax Collection Agreement during the first two years:

Time Period	Number of Large Direct Marketers Participating	Annual Sales of Participants
First 6 months	10 companies	\$1.25 billion
First year	20 companies	\$2 billion
First two years	45 companies	\$3 1/2 billion

If the agreement is "working" after two years, I would expect that participation would continue to grow. This belief is shared by all of our negotiating group and is based on a number of factors:

1. It may take a year or two of industry experience with a simplified tax system for some companies to recognize it as a new reality and rethink old assumptions.

2. New technologies and new marketing techniques will make it more advantageous for companies to take tax considerations out of their business decisions.

3. Once one or two companies in a specific market "take the plunge," it will be much easier for competitors to follow suit.

There are also companies not counted in the estimate for the first two years which neverthless may choose to participate in the agreement during that time period. They fall into three categories:

1. A number of interested companies polled could not give any kind of commitment at this time because there was insufficient time to study the draft agreement and analyze its impact on the company. Although the negotiations have been going on for almost two years and have been well publicized in the industry, most companies did not give the potential agreement the kind of analysis and top management attention it needs while the agreement was still evolving.

2. I have received a few calls in the past six months from fairly large national marketers who are not DMA members but who have expressed an interest in the voluntary agreement. I have no way of getting a firm indication of the intention of companies in this group and, therefore, did not include them.

3. Business-to-business direct marketers have expressed some interest in a voluntary tax collection agreement during the negotiations. However, the burden of dealing with exempt buyers and exempt transactions would be a major impediment.

   The current system would force business-to-business marketers with national tax collecting responsibilities to keep on file literally millions of exemption

> certificates. The draft agreement promises that "the Party states...shall study the compliance issues raised by sales to exempt organizations and exempted transactions, such as sale for resale, and within six months of the effective date of this agreement shall develop administrative procedures that will reduce the compliance burdens associated with such transactions" (Article IV, Section 4d).
>
> The problem of documenting an exempt sale for resale has been specifically addressed in the agreement. However, the resale exemption is only a small part of this overall problem, I am told. If the other issues can be handled as well in the next six months, then additional participation by a half dozen or so companies (with over $1 billion dollars in annual sales) is possible. At this time, however, none of the companies concerned with this issue can make a commitment based upon promises of simplifications in the future.

One final point. I am aware that the revenue projections for this agreement are likely to be measured by your member states against a backdrop of expectations created by mail order tax revenue estimates based upon the study commissioned by the Advisory Commission on Intergovernmental Relations (ACIR) in 1985. I want to repeat for the record that those figures are inaccurate.

The ACIR revenue estimates are based on industry sales figures which include large categories of sales-tax-exempt items such as insurance and investment contracts. In addition, dozens of large direct marketers (other than Sears and Penneys) with substantial presence in multiple states, such as American Express, Columbia Book and Record Club, IBM Direct, etc., were left in the industry sales figures used by ACIR despite the fact that their sales are already subject to a collection duty. Finally, the revenue charts produced for lobbying purposes do not even reflect the adjustments that were made. (The ACIR charts use admittedly "unadjusted" figures.)

Our figures indicate that less than $8 billion in untaxed mail order sales are generated annually by companies with over $12.5 million in gross annual sales. A voluntary agreement has a good chance of bringing 40 to 50 percent of that money into the

Harley Duncan
Dan Bucks
Page 5

collection system within 3 or 4 years. A voluntary system has the additional enormous advantage of being vastly more efficient both for business and government. I hope that your member states will recognize that this agreement could bring in almost as much <u>net</u> revenue as a compulsory system and do so in a far shorter time period than relying on the uncertain prospects for federal enabling legislation.

I continue to believe that this voluntary approach with its incentives to simplify and standardize national tax collecting has advantages for all the parties and for the country. I hope it works. Many thanks to you and the rest of the state negotiating team for your open-mindedness and perseverance. If there is anything more I can do, please let me know.

Sincerely,

Bob

Robert J. Levering

RJL/gap

FEDERATION OF TAX ADMINISTRATORS

444 North Capitol St., NW. Washington. D.C 20001 • (202) 624-5890

December 16, 1992

VIA FACSIMILE

Mr. Robert J. Levering
Sr. Vice President, Catalog Issues
Direct Marketing Association, Inc.
1101 17th Street, NW
Washington, DC 20036

Dear Bob:

Thank you for your prompt and timely response to the states' request for information on the expected level of participation in the proposed Voluntary Tax Collection Agreement. It was extremely helpful to the governing boards of the Federation of Tax Administrators and the Multistate Tax Commission in their evaluation of the proposed agreement.

We believe, as you do, that the discussions between the direct marketing industry and state tax administrators made substantial progress in narrowing the range of differences between the two parties and in increasing the understanding and appreciation of each party for the position of the other. Both parties, we believe, operated in good faith throughout the negotiations by clearly and accurately representing the position of their principals and by striving to reach an agreement acceptable to both sides.

By concurrent action taken on December 10, 1992, the FTA Board of Trustees and MTC Executive Committee found the Voluntary Tax Collection Agreement resulting from the negotiating process to be unacceptable. Accordingly, they determined that the proposal should not be forwarded to the National Governors' Association. Further, the governing boards instructed us to prepare an explanation of the groups' assessment of the proposed agreement to be shared with other organizations of government officials. The boards also specifically indicated that they did not want their actions to preclude the pursuit of federal legislation as the proper course for a uniform resolution of the issue of collecting state and local sales use taxes on goods shipped into a state.

The action of the governing boards was driven in large part by their conclusion that the proposal did not further significantly the achievement of their primary aim throughout these discussions. Namely, it has been the purpose of administrators through these discussions to bring about a substantial parity between local retailers who must collect tax on their sales and direct marketers who sell similar items into a state without the collection of tax. The level of voluntary compliance to be expected under the proposal did little to "level the playing field" and provide for consistent treatment of local

retailers and direct marketers. When coupled with the conditions regarding future federal legislative activities and the treatment of local government taxes, state administrators simply concluded that too much was being asked and too little was being achieved.

On behalf of the entire state negotiating team, we want to thank you, George Isaacson and others from the marketing industry for your hard work and efforts in developing the proposed collection agreement. While it would appear we have not achieved a successful conclusion at this point, perhaps we shall have the opportunity to work on matters of mutual concern in the future. Please feel free to contact either of us if you require further information on this or any other matter.

With every best wish we remain,

Sincerely,

Dan R. Bucks, Executive Director
Multistate Tax Commission

Harley T. Duncan, Executive Director
Federation of Tax Administrators

cc. George Isaacson
James Buresh
Terry Schroeder

MAINE ALTERNATIVE

Currently ten states collect use tax directly from consumers through the state's income tax form. However, only the State of Maine of these ten states has an effective method for collecting mail order use taxes. The Maine statute, which took effect in 1991, led to the collection of $1.7 million of an estimated $7.3 million of use tax owed or 23 percent of the estimated amount owed.

While a number of states list a line on their income tax forms to attempt to collect use tax on out-of-state purchases, only Maine has a "default provision." If a Maine taxpayer leaves the line blank (thus declaring no purchases from out-of-state marketers were made), or fails to sign that line of the form (under penalty of perjury), then the state automatically adds an amount equal to the average tax owed on out-of-state purchases, calculated at 0.0366 percent of the taxpayer's taxable income. For example, if a taxpayer has $30,000 of taxable income, the tax would be $11.00. The Maine statute also requires (under penalty of perjury) listing any mail order purchase which exceeds $500. Maine's collection level of 23 percent is significant since 1991 was the first year of implementation of the new statute and the state employed no added enforcement effort to increase compliance with the new provision.

April 13, 1994

The Honorable Dale Bumpers
Chairman
Senate Small Business Committee
428-A Russell Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

On behalf of the hundreds of thousands of American businesses (both for profit and not for profit) represented by our organizations, we urge you to oppose federal use tax legislation, the subject of hearings today before the Senate Small Business Committee. "The Tax Fairness for Main Street Businesses Act" (S. 1825) would unfairly threaten the survival of thousands of mail order companies, hundreds of thousands of other national marketers and seriously damage many industry suppliers.

If passed, national marketers, the majority of which are defined as "small businesses," would be forced to shoulder the administrative burdens of collecting and remitting taxes for 45 states and the District of Columbia according to 6,100 different rates and 46 sets of exemptions and diverse compliance rules. In 1992, it would have amounted to compiling, preparing and filing over 428 returns each month, 5,136 returns a year or 21 returns on a daily basis for some companies. They would also be subject to time-intensive audits by more than 432 jurisdictions that administer sales and use taxes throughout the country.

The "in lieu" provision which provides businesses with the opportunity to collect taxes according to the average local tax rate is unworkable. Consumers should not be asked to pay more than they owe and responsible marketers would not ask them to. Likewise, computer tax collection systems are cost-prohibitive for small to mid-size firms above the $3 million threshold and do not handle half of the compliance costs of collecting use taxes -- the costs incurred from communicating tax instructions to customers and customer failure to pay the tax. The compliance costs alone would be 6.5 times greater for national marketers than for local retailers who deal with only one rate and one set of exemptions.

A dramatic loss in sales will result due to the increased complexity for customers in placing orders, loss of valuable catalog advertising space to explain tax rates and exemptions, and higher prices. Mail order companies estimate this loss to be as much as 20 percent which will be felt by thousands of suppliers including printers, list brokers, paper manufacturers, service bureaus, advertising agencies, etc. which support the direct marketing industry.

Revenue estimates offered by the bill's proponents are significantly inflated and do not

account for taxes already being collected by direct marketers who have a presence in the state and for sales of tax exempt products. Further, these estimates do not take into account the various collateral effects. Sales of marketing companies and their suppliers would drop reducing corporate income and payroll tax receipts. Net sales tax revenue would also be lower for states due to added enforcement costs. Accordingly, this is a tax collection system that is ill-suited to the national marketplace.

This is an unfair, inefficient and unnecessary way to collect revenue. We urge you to actively oppose it.

Sincerely,

American Advertising Federation

American Association of Nurserymen

American Stamp Dealers Association

Antiquarian Booksellers Association of America, Inc.

Associated Credit Bureaus, Inc.

Association of American University Presses

Center for Science in the Public Interest

Classroom Publishers Association

Direct Marketing Association, Inc.

Florida Gift Fruit Shippers Association

Incentive Federation, Inc.

Industry Council on Tangible Assets

Mail Advertising Service Association, International

Mailorder Association of Nurseries

Newsletter Publishers Association

Printing Industries of America, Inc.

Promotional Products Association, International

April 13, 1994

The Honorable Dale Bumpers
Chairman
Senate Small Business Committee
428-A Russell Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

For more than 97.7 million American consumers mail order shopping is an indispensable convenience, if not a necessity. This is particularly true for such groups as the elderly, the disabled, rural families, working mothers and single parents, who by reason of physical condition, geographic isolation or lack of time, have few, if any other shopping alternatives for many products. On behalf of the millions of consumers represented by our organizations, we urge you to oppose federal use tax legislation, the subject of hearings today before the Senate Small Business Committee.

If "The Tax Fairness for Main Street Businesses Act" (S. 1825) is passed and direct marketers are forced to collect use taxes from out-of-state customers, mail order shopping would become confusing, cumbersome and expensive. The complexities of state tax laws would intrude into the lives of every mail order consumer, particularly the 35 percent who pay by check. The fate of the customer's order will depend upon his or her ability to properly answer such difficult questions as: What state and local tax is applicable? Is the item taxable? What is the tax rate? Are shipping and handling taxable? At what rate? How much should I write my check for? (Consider calculating $29.95 x .04225 percent -- it's not easy.)

Furthermore, the administrative costs and inefficiencies imposed upon direct marketers would result in increased prices, decreased services and fewer choices for consumers. For many, mail order shopping provides access to products necessary for everyday life, as well as to health care products, medical equipment, and many other specialty items not otherwise available in retail stores.

Mail order opportunities enrich the marketplace providing greater choices to consumers. We urge you to oppose this unfair and inefficient means of tax collection.

Sincerely,

American Council of the Blind

Disabled American Veterans

Fight Back! Foundation for Consumer Education

National Alliance of Senior Citizens

National Association for Home Care

National Association of People With AIDS

National Grange

Paralyzed Veterans of America

Veterans of Foreign Wars

World Institute on Disability

Direct Marketing: Serving the American Marketplace

Use Tax Burden On Catalogers Would Upset U.S. Economy

Federal use tax legislation would effectively depress direct marketing sales.

Tax collecting through the mail is cumbersome. The more than 30 million Americans who pay for mail order items by check would have to calculate their own taxes according to varying rates before ordering. This will result in lost sales.

Most of these sales would be lost to the economy altogether and would not be picked up by retail stores. The lost sales would include the many discretionary purchases made only because of the convenience of direct marketing and the ability of direct marketing to bring a great variety of products to the attention of consumers who do not have the time nor the opportunity to buy them otherwise.

Businesses would be forced to collect taxes according to the different rates of 6,000 local jurisdictions as well as the varying procedures and exemption schedules of 46 states. This would impose unproductive costs on the direct marketing business and force the closing of a number of mail order companies.

USE TAX BURDEN ON CATALOGERS WOULD UPSET U.S. ECONOMY

	Direct Response Business*		Retail Trade**	
	$/Emp.	% Ch.	$/Emp.	% Ch.
1990	109,309	0.08	103,794	0.01
1991	108,722	-0.54	102,708	-1.05
1992	110,330	1.48	104,945	2.18
1993	111,110	0.71	107,487	2.42
1994	113,495	2.15	111,819	4.03
1995	115,211	1.51	113,812	1.78

The direct response industry and the retail industry each generate one job for every $100,000 in sales. Any gains in the retail business from placing tax burdens on mail order businesses and their customers would be offset entirely by an equal loss in the number of Americans employed in catalog companies, publishers, printers, advertising agencies and others in the direct-response business.

*Total real sales attributed to direct response advertising divided by total employment involved in all facets of the business that support this amount of business.

**Total real retail trade sales divided by total employment.

The WEFA Group, 1994

Direct Marketing: Serving the American Marketplace

Catalogs
An Economic Force

Catalog Revenues *in billions of dollars*	1987	35.7
	1991	48.8
	1993	53.4
	1996	65.2*
Catalog Employment *in thousands*	1987	281.3
	1991	335.2
	1993	333.7
	1996	354.0*
Catalog Linked Employment *in thousands*	1987	950
	1991	1,170
	1993	1,199
	1996	1,370*
Catalog Contribution to the Gross Domestic Product *in billions of dollars*	1987	28.6
	1991	39.9
	1993	43.2
	1996	50.9*

Statistics: The WEFA Group
**Projected figures provided the USPS proposed 10.3% across-the-board rate increase is upheld in the R'94 rate case.*

...And A Consumer Choice

Catalogs have been filling American needs since Montgomery Ward and Sears, in the 1870s, began to serve an agrarian nation. Today, time has become a valuable commodity, as single-parent and two-income families proliferate. Shopping direct through catalogs has never been more convenient, reliable or cost-effective, not only for the time-deprived but for those who live in rural areas, the elderly and disabled. In 1993, more than half the adult American population ordered merchandise by mail or phone.*

**Simmons Market Research Bureau*

ANALYSIS OF RETURN ON SALES
COMPARISON OF SELECTED RETAIL AND CATALOG COMPANIES
(000 omitted)

CATEGORY	COMPANY	SYMBO	EXCHANGE	YEAR END	REVENUES FY1993(1)	REVENUES FY1994(1)	PRE-TAX EARNINGS FY1993(1)	PRE-TAX EARNINGS FY1994(1)	PERCENT REVENUES FY1993(1)	PERCENT REVENUES FY1994(1)
RETAIL										
APPAREL	GAP (2)	GPS	NYSE	JAN	2,960,109 0	3,295,679 0	339,811 0	424,888 0	11 48%	12 89%
	S & K FAMOUS BRANDS (2)	SKFB	NASDAQ	JAN	87,023 9	98,976 3	8,908 3	6,488 6	10 24%	6 56%
	A PEA IN THE POD (2)	APOD	NASDAQ	JAN	29,810 0	40,900 0	2,200 0	470 0	7 38%	1 15%
	G-III APPAREL (2)	GIII	NASDAQ	JAN	195,700 0	208,900 0	7,300 0	240 0	3 73%	0 11%
	CHARMING STORES (2)	CHRS	NASDAQ	JAN	1,178,714 0	1,254,122 0	119,133 0	11,732 0	10 11%	0 94%
	PETRIE STORES (2)	PST	NYSE	JAN	1,438,160 0	1,480,071 0	23,042.0	77,452 0	1 60%	5 23%
	CATO CORPORATION (2)	CACOC	NASDAQ	JAN	331,262 0	407,878 0	29,722 0	38,334 0	8 97%	9 40%
	STEIN MART (3)	SMRT	NASDAQ	DEC	278,254 0	342,730 0	13,928 0	27,653 0	5 01%	8 07%
	AVERAGE FOR CATEGORY				722,114 8	792,139 6	60,449 4	65,250 8	8 37%	8 24%
CATALOG										
APPAREL	LANDS END (2)	LE	NYSE	JAN	733,623 0	869,975 0	51,033 0	69,870 0	6 96%	8 03%
	DM MANAGEMENT (3)	DMMC	NASDAQ	JUN	11,532 0	17,510 0	(2,411 0)	1,608 0	-20 91%	9 18%
	HANOVER DIRECT (3)	HNV	ASE	DEC	586,562 0	642,511 0	1,267 0	17,207 0	0 22%	2 68%
	FINGERHUT (3)	FHT	NYSE	DEC	1,470,628 0	1,634,009 0	93,930 0	111,879 0	6 39%	6 85%
	SPIEGEL (3)	SPGLA	NASDAQ	DEC	1,972,283 0	2,337,235 0	69,367 0	87,363 0	3 52%	3 74%
	INITIO (2)	INTO	BULLETIN BO	APR	13,351 0	18,888 0	(575 7)	626 7	-4 31%	3 32%
	BLAIR (3)	BL	ASE	DEC	500,168 2	519,174 3	60,833 6	51,551 1	12 16%	9 93%
	AVERAGE FOR CATEGORY				755,449 6	862,757 5	39,063 4	48,586 4	5 17%	5 63%
RETAIL										
BUSINESS SUPPLIES	OFFICE DEPOT (3)	ODD	NYSE	DEC	1,732,965 0	2,579,494 0	62,053 0	106,520.0	3 58%	4 13%
	STAPLES (2)	SPLS	NASDAQ	JAN	883,088 0	1,121,781 0	27,732.0	40,353 0	3 14%	3 60%
	COMP USA (3)	CPU	NYSE	JUN	820,779 0	1,341,985 0	10,082 0	19,816 0	1.23%	1.48%
	COMPAC (3)	CPQ	NYSE	DEC	4,100,000 0	7,191,000 0	295,000 0	616,000.0	7 20%	8 57%
	AVERAGE FOR CATEGORY				1,507,366 4	2,446,852 0	78,973 4	156,537 8	5 24%	6 40%
CATALOG										
BUSINESS SUPPLIES	VIKING OFFICE PRODUCTS (2)	VKNG	NASDAQ	JUN	449,687.0	565,057 0	32,129 0	47,671 0	7 14%	8 44%
	NEW ENGLAND BUSINESS SERVI	NEBS	NASDAQ	JUN	232,135.0	237,144 0	24,862.0	24,090.0	10.71%	10 16%
	INMAC (3)	INMC	NASDAQ	JUL	312,887.0	342,027 0	4,571.0	(10,698.0)	1.46%	-3.13%
	DELL COMPUTER (2)	DELL	NYSE	JAN	889,939.0	2,013,924 0	73,415 0	143,292.0	8.25%	7.12%
	AVERAGE FOR CATEGORY				471,162 0	789,538 0	33,744 3	51,088 8	7 16%	6 47%
	TOTAL RETAIL AVERAGES				1,079,681 9	1,489,501 3	72,223 9	105,380.5	6 69%	7 07%
	TOTAL CATALOG AVERAGES				652,072.3	836,132 2	37,129 2	49,496.3	5 69%	5 92%

(1) THE REVENUES AND EARNINGS ARE FOR LATEST FISCAL YEARS OF THE COMPANY
(2) THESE COMPANIES RESULTS ARE FOR FISCAL YEARS 1993 AND 1994, THEIR LATEST REPORTED RESULTS
(3) THESE COMPANIES RESULTS ARE FOR FISCAL YEARS 1992 AND 1993, THEIR LATEST REPORTED RESULTS

Prepared by Bruce, Dean and Co with the assistance of Adam Beroza, University of Virginia

United States House of Representatives
Committee on Small Business
Subcommittee on Procurement, Taxation and Tourism

Testimony of
JAMES E. MAURIN
Chairman and Chief Executive Officer
Stirling Properties
and
Managing Partner
Maurin-Ogden Properties
on behalf of
INTERNATIONAL COUNCIL OF SHOPPING CENTERS

on

INTERSTATE SALES TAX COLLECTION

September 27, 1994

Contact:
Ellen B. Marshall
International Council of
Shopping Centers
1199 N. Fairfax Street, Ste. 204
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Good afternoon. My name is James E. Maurin, and I am Chairman and Chief Executive Officer of Stirling Properties and Managing Partner of Maurin-Ogden Properties in New Orleans, Louisiana. Combined, these two companies own and operate 42 shopping centers in the Gulf South, principally in Louisiana. These centers employ over 10,000 people in retail outlets including discount and electronics stores and small "mom and pop" operations. I would like to thank Chairman Bilbray and the members of the Subcommittee for conducting this hearing today, and for bringing greater focus to the "tax avoidance" situation which has created a marketplace inequity between traditional retailers and the direct marketing industry and in the process is threatening the future stability of the retail industry.

I am presenting my testimony today on behalf of the International Council of Shopping Centers, of which I am a member. ICSC is the trade association of the shopping center industry, and its 25,000 members represent the owners, developers, retailers, financiers, brokers, and all other professionals involved in the shopping center industry. There are over 39,000 shopping centers in the United States and these centers generated in excess of $790 billion in retail sales in 1993 -- and remitted $33 billion in state and local sales tax receipts. Shopping centers are also one of the biggest employers in this country creating jobs for nearly 10 million people, or, roughly, 1 of every 9 non-agricultural jobs in the United States. It is also important to note that the majority of shopping centers are not the "mega malls" that everyone writes about in the newspapers. In reality, nearly 85% of shopping centers occupy less than 200,000 square feet of leasable space -- roughly equivalent to a medium-size department store, drug store, and maybe three or four other small retail outlets. Many of these smaller shopping centers are the very lifeblood of the communities in which they are located, and often times they are the primary provider of tax revenue on which the community survives.

Mr. Chairman, for many years Congress has searched for ways to break down the barriers to free trade and fair competition between the United States and its foreign trading partners. However, while we labor to eliminate foreign barriers we largely ignore one barrier to fair competition which exists within our own borders. The problem is simple: traditional retailers must collect state and local sales taxes on consumer purchases at the point of sale, but direct marketers are not required to collect most of these taxes, and, instead are able to push the burden of sales tax remittance on to the shoulders of their customers.

This situation creates a tremendous pricing gap between traditional retailers and direct marketing companies, allowing direct marketers to sell comparable, or at times identical, merchandise at much lower prices simply because they do not have to tack on the 6-8% sales tax that is common in most areas. But the problems created extend much further than differences in price -- this inequity affects employment and state and local economies to an extent that I imagine many members of the Subcommittee fail to realize.

In practical terms, however, what does this "tax avoidance" mean on a typical retail sale? Let's say that I go into a men's clothing store in Baton Rouge to buy a suit. The clothing store can buy the suit wholesale for $200 and decides to sell the suit to me for $300. If you add on the sales tax of 8%, the total cost to me is $324. However, a mail order company (that has no stores in Louisiana) may offer the same suit, and because they are not required to collect sales tax, their total price is $300. Therefore, in order to stay competitive the retail store will have to lower their sales price to about $275 so that their total price, including tax, is in the same range as that of the mail order company.

What results from this one example is a "domino effect" for both the shopping center industry and local economies. Retailers are forced to operate on smaller (or sometimes nonexistent) profit margins. They hire fewer employees. Some are even forced to shut down. And fewer sales in local retail stores means a decrease in sales tax revenues available for use by state and local governments.

It is important, however, to examine the changing marketplace to realize the current and future impact of this tax inequity. Extraordinary changes are taking place in the retail marketplace -- and the definition of "shopping" is undergoing a transformation. With the advent of expanded use of catalog merchandising and video shopping services, consumers are taking advantage of the luxury of shopping from the comfort of their own home in lieu of patronizing their hometown merchants. The following points illustrate the striking changes that are taking place:

- Over the past several years, the increase in retail sales in shopping centers has remained steady at under 5 percent per year, while retail sales for the direct marketing industry show a more dramatic increase -- up 14 percent from 1992 to 1993, and sales are expected to increase at 6% or better each year through the year 2000. For 1993, the Direct Marketing Association reports sales of over $234 billion -- or roughly 30% of the total retail sales generated by shopping centers. And although in 1993 over $33 billion in sales tax revenues were collected and remitted by retailers in shopping centers, state and local sales taxes were collected on only a very small percentage of $234 billion in sales by direct marketing companies.

- As I stated earlier, nearly 10 million people in the U.S. are employed in shopping centers. The mail order catalog industry, however, employs less than 200,000 across the country.

- Additional sources for so-called "tax-free" shopping are rapidly becoming available to consumers. Interactive television, online computer services, and electronic shopping for airline passengers are just a few examples of direct marketing services which stand to grab a greater share of the traditional retail market in the next decade.

These points illustrate the changing retail marketplace -- but let's take a look at some of the problems caused by the tax inequity between traditional retailers and direct marketing companies. The sales tax revenues generated by local retailers get funneled back into local economies to fund services such as schools, police and fire protection, and infrastructure improvements to roads and bridges. But a big mail order company on the east coast often times is not required to contribute sales tax revenues to cities and towns in Louisiana even though they ship millions of dollars of merchandise each year into the state while taking full advantage of many of Louisiana's state and local services which are funded by sales tax revenues.

In addition, as the pool of tax revenues available to state and local governments decreases, legislators must look for ways to make ends meet. Often times, they increase the taxes on local companies "for the privilege of doing business in the community". These tax increases are another blow to the small retailer who is already having a hard time making ends meet. Instead of increasing taxes, wouldn't it make more sense in this situation to ask everyone -- including direct marketing companies -- who takes advantage of the privilege of doing business in the community to collect and remit state and local sales taxes at the point of purchase?

And, most importantly, for every purchase that a consumer makes from an out-of-state direct marketing company another in-state retail job is put in jeopardy. Members of the Subcommittee, how many of the constituents in your district receive a paycheck from a big out-of-state mail order company?

Mr. Chairman, I am proud that the Louisiana State Senate recently passed a resolution urging the U.S. Congress to protect the traditional retail industry by passing interstate sales tax legislation, and I implore the members of the Subcommittee to take up the challenge. It is time to end the tax subsidization of the direct marketing industry. Allow traditional retailers and direct marketers to play by the same set of rules -- retailers are certainly up to the challenge of competing on a level playing field. In doing so, you will tear down barriers to fair competition, preserve and create jobs, and provide badly needed revenue for state and local economies.

Thank you for allowing me to present my testimony today, and I will be happy to answer any questions you have.

National League of Cities

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TESTIMONY OF

THE HONORABLE JAMES B. MCNEER

MAYOR OF COLONIAL HEIGHTS, VIRGINIA

ON BEHALF OF

THE NATIONAL LEAGUE OF CITIES

AND

THE UNITED STATES CONFERENCE OF MAYORS

BEFORE

THE COMMITTEE ON SMALL BUSINESS

SUBCOMMITTEE ON PROCUREMENT, TAXATION AND TOURISM

UNITED STATES HOUSE OF REPRESENTATIVES

SEPTEMBER 27, 1994

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, I AM JAMES B. MCNEER, MAYOR OF COLONIAL HEIGHTS, VIRGINIA AND PROVOST AND DEAN OF FACULTY AT RICHARD BLAND COLLEGE, COLLEGE OF WILLIAM AND MARY. I APPEAR BEFORE THIS COMMITTEE TODAY ON BEHALF OF BOTH THE NATIONAL LEAGUE OF CITIES, AND THE UNITED STATES CONFERENCE OF MAYORS AND I APPRECIATE THE OPPORTUNITY TO EXPRESS OUR STRONG SUPPORT FOR S. 1825, THE "TAX FAIRNESS FOR MAIN STREET BUSINESS ACT OF 1994," WHICH WAS INTRODUCED BY SENATOR DALE BUMPERS IN LATE JANUARY.

THE ISSUES SURROUNDING THE COLLECTION OF SALES TAX BY OUT-OF-STATE FIRMS IS NOT NEW TO LOCAL GOVERNMENTS. IT WAS BACK IN 1988 THAT A COALITION OF STATE AND LOCAL GOVERNMENTS DEVELOPED A CONSENSUS APPROACH TO THE COLLECTION OF OUT-OF-STATE SALES TAX THAT ACCOMPLISHED TWO CRITICAL OBJECTIVES. FIRST, THE CONSENSUS APPROACH WAS DESIGNED TO ENSURE THAT BOTH STATES AND LOCAL GOVERNMENTS SHARE EQUITABLY IN THE REVENUES GENERATED BY THE COLLECTION OF SALES TAX. SECOND, THE CONSENSUS APPROACH WAS DESIGNED TO SIMPLIFY THE COLLECTION OF SALES TAX FOR DIRECT MARKETING COMPANIES BY ESTABLISHING AN IN-LIEU FEE IN STATES WHERE THE LOCAL SALES TAX RATES ARE NOT UNIFORM.

IT IS WITH GREAT SATISFACTION THAT WE NOW FIND THE CONSENSUS APPROACH DEVELOPED BY THE STATE AND LOCAL COALITION INCLUDED IN S. 1825. WE ARE ALSO PLEASED TO JOIN IN A REINVIGORATED COALITION EFFORT WITH THE LOCAL RETAIL COMMUNITY IN SUPPORTING THIS NEW LEGISLATION.

MR. CHAIRMAN, I WOULD LIKE TO BEGIN BY MAKING SEVERAL IMPORTANT POINTS. FIRST, S.1825 DOES NOT IMPOSE A NEW TAX. IN FACT, CONSUMERS ARE CURRENTLY REQUIRED BY LAW TO PAY SALES TAXES IN THEIR HOME JURISDICTIONS WHEN THEY PURCHASE GOODS FROM OUT-OF-STATE RETAILERS; HOWEVER, MANY DO NOT, AND OUT-OF-STATE RETAILERS ARE NOT PRESENTLY REQUIRED TO COLLECT AND REMIT SALES TAXES. WHAT WE ARE SUPPORTING IN S. 1825 IS SIMPLY CORRECTING THIS FEDERAL LOOPHOLE WHICH IMPROPERLY IMMUNIZES DIRECT MARKETING

FIRMS FROM THEIR RESPONSIBILITY TO COLLECT AND REMIT EXISTING SALES TAXES.

SECOND, IN THE CURRENT ERA OF HIGH TECHNOLOGY AND THE INFORMATION SUPERHIGHWAY, DIRECT MARKETING FIRMS ARE NOW, MORE THAN EVER, CAPABLE OF COLLECTING AND REMITTING STATE AND LOCAL SALES TAXES WITH MINIMUM EXPENSE.

THIRD, S. 1825 FURTHER MINIMIZES THE EFFORT AND EXPENSE FOR DIRECT MARKETING FIRMS BY REQUIRING A SINGLE TAX COLLECTION RATE FOR EACH STATE, EITHER UNIFIED OR "IN-LIEU," FOR THE PURPOSES OF THIS ACT, AND EXEMPTING SMALLER FIRMS FROM THE REQUIREMENT TO COLLECT THE TAX.

THE POTENTIAL REVENUE BENEFITS FROM THIS LEGISLATION FOR STATE AND LOCAL GOVERNMENTS HAVE BEEN WELL DOCUMENTED. ATTACHED TO MY WRITTEN TESTIMONY IS AN ESTIMATED REVENUE CHART FOR 1994, PREPARED BY THE ADVISORY COUNCIL ON INTERGOVERNMENTAL RELATIONS, WHICH I BELIEVE SPEAKS FOR ITSELF. AS YOU CAN SEE, THE STATE OF VIRGINIA WOULD HAVE GAINED $59.9 MILLION IN 1994 FROM THE COLLECTION OF STATE AND LOCAL SALES TAXES. OF THAT TOTAL, THE CITY ESTIMATES THAT COLONIAL HEIGHTS WOULD HAVE GAINED $100 THOUSAND IN FISCAL YEAR 1994. OUR TOTAL BUDGET WAS APPROXIMATELY $22.6 MILLION, OF WHICH $3.7 MILLION CAME FROM SALES TAX REVENUES. THE ESTIMATED $100 THOUSAND WOULD REPRESENT A 2.7 PERCENT INCREASE IN LOCAL OPTION SALES TAX REVENUES RAISED.

IN ADDITION TO THE DIRECT REVENUE BENEFITS FOR STATE AND LOCAL GOVERNMENTS, THE "TAX FAIRNESS FOR MAIN STREET BUSINESS ACT" WOULD HELP LEVEL THE PLAYING FIELD SO-TO-SPEAK FOR LOCAL SMALL BUSINESSES. THE ECONOMIC REALITIES OF INFRASTRUCTURE DEFICITS AND CRIME HAVE MADE IT DIFFICULT ENOUGH FOR SMALLER BUSINESSES TO SURVIVE, LET ALONE GROW, IN AN INCREASING NUMBER OF CITIES AND TOWNS. WE HAVE WITNESSED IN COLONIAL HEIGHTS AND OTHER NEIGHBORING CITIES THE CLOSING OF MANY OF OUR SMALL BUSINESSES

AND SUFFERED THE ENSUING LOSS OF RETAIL JOBS AND OVERALL DECLINE IN ECONOMIC CONDITIONS. THESE PROBLEMS ARE BEING ADDRESSED IN A COOPERATIVE MANNER BY ALL LEVELS OF GOVERNMENT; LOCAL, STATE, AND FEDERAL. HOWEVER, WE FIND IT ABSOLUTELY UNFORGIVABLE THAT IN ADDITION TO THE IMPEDIMENTS FACING SMALL BUSINESSES WHICH WE ARE WORKING TOGETHER TO ADDRESS, OUR LOCAL RETAIL COMMUNITIES ARE PLACED AT A COMPETITIVE DISADVANTAGE VIS-A-VIS DIRECT MARKETING FIRMS WHICH HAVE THE ADVANTAGES OF NOT ONLY THE EXISTING AND EVER IMPROVING SYSTEMS OF MASS COMMUNICATION AND ADVERTISING, BUT ARE ALSO FREE FROM THE REQUIREMENT TO COLLECT STATE AND LOCAL SALES TAXES.

THE COMPETITIVE ADVANTAGE ENJOYED BY DIRECT MARKETING FIRMS IS NOT LIMITED TO THE PROTECTION FROM THE COLLECTION OF STATE AND LOCAL SALES TAXES. DIRECT MARKETING FIRMS ARE DEPENDENT UPON THE SERVICES AND INFRASTRUCTURE PROVIDED BY STATE AND LOCAL GOVERNMENTS. OUR ROADS ARE USED IN PRODUCT DELIVERY. OUR POLICE PROTECT PRODUCT DELIVERY. OUR COURTS HANDLE CASES OF NONPAYMENT AND PRODUCT THEFT.

TO BE MORE SPECIFIC, LET'S LOOK AT THE ISSUE OF LANDFILL DISPOSAL. MILLIONS OF MAIL ORDER CATALOGUES END UP IN LOCAL LANDFILLS EVERY YEAR. AS A RESULT, LOCAL GOVERNMENTS INCUR SIGNIFICANT COSTS TO COVER THE EXPENSE OF DISPOSAL OR RECYCLING OF THESE CATALOGUES. HOWEVER, LOCAL GOVERNMENTS, BY THEIR VERY NATURE, MUST TURN TO THE PUBLIC TO PAY FOR THESE INCREASED COSTS. IN PRESENT TIMES IT HAS INCREASINGLY BECOME THE LOCAL RETAIL COMMUNITY WHICH HAS BEEN FORCED TO CHARGE HIGHER SALES TAXES, AND PAY HIGHER INCOME TAXES AND USER FEES TO COVER THESE INFRASTRUCTURE COSTS. THEREFORE, THE COLLECTION OF SALES TAX FROM DIRECT MARKETING FIRMS WILL NOT ONLY INCREASE REVENUES FOR STATE AND LOCAL GOVERNMENTS, BUT ALSO HELP SPREAD THE BURDEN OF WASTE DISPOSAL AND OTHER PUBLIC INFRASTRUCTURE IMPROVEMENTS PRESENTLY BOURN, IN LARGE MEASURE, BY THE LOCAL RETAIL COMMUNITY. MR. CHAIRMAN, AMERICA'S CITIES AND TOWNS ARE AT A PIVOTAL

JUNCTURE IN THEIR ECONOMIC HISTORY. AS WE ARE ALL AWARE, THE NEW ECONOMIC REVOLUTION IS FUELED BY SMALLER BUSINESSES THAT ARE ADAPTABLE AND AGILE. THE LARGE CORPORATIONS WHICH PROVIDED SO MANY OF THE JOB OPPORTUNITIES FOR OUR RESIDENTS ARE DOWNSIZING, RESULTING IN A PERIOD OF MAJOR JOB LOSS WHICH CONTINUES TODAY. ENSURING ECONOMIC OPPORTUNITIES AND A LEVEL PLAYING FIELD FOR SMALL, COMMERCIAL ENTERPRISES IS AN IMPORTANT STEP FOR OUR ECONOMY.

UNFORTUNATELY, THE SMALLER BUSINESSES WHICH NOW PLAY SUCH A LARGE ROLE IN SUSTAINING OUR ECONOMY AND PROVIDING FOR ECONOMIC RECOVERY HAVE FOUND IT INCREASINGLY DIFFICULT TO SURVIVE OR EXPAND IN MANY CITIES. THIS BASIC PROBLEM FOUND EXPRESSION IN THE EMPOWERMENT ZONE AND ENTERPRISE COMMUNITY (EZ/EC) PROGRAM ENACTED INTO LAW IN 1993. THE ENACTMENT OF THE EZ/EC PROGRAM RESULTED FROM A GENERAL AGREEMENT ON BOTH THE ECONOMIC AND SOCIAL NEED TO PROVIDE OPPORTUNITIES FOR PEOPLE TO WORK IN THEIR COMMUNITIES, TO BECOME OWNERS OF SMALL BUSINESSES IN THEIR COMMUNITIES, AND TO BECOME LEADERS IN THEIR COMMUNITIES.

AS BOTH THE ADMINISTRATION AND MANY MEMBERS OF CONGRESS EXPRESSED DURING THE DEBATE ON EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES, THE UNDERPINNING INTENT OF THE PROGRAM IS TO BOTH ATTRACT NEW SMALL TO MEDIUM SIZED BUSINESSES INTO DISTRESSED URBAN AND RURAL CITIES AND TOWNS, AND TO PROVIDE INCENTIVES TO EXISTING SMALL BUSINESSES TO EXPAND THEIR ACTIVITIES AND THUS PROVIDE FOR NEW JOB OPPORTUNITIES.

THE NATIONAL LEAGUE OF CITIES AND THE UNITED STATES CONFERENCE OF MAYORS ACTIVELY SUPPORTED THE CREATION OF THIS DEMONSTRATION PROGRAM AND AGREE WITH THE NEED TO FIND INNOVATIVE NEW WEAPONS IN THE BATTLE AGAINST DECAY AND UNEMPLOYMENT IN OUR CITES. IN OUR OPINION, THE "TAX FAIRNESS FOR MAIN STREET BUSINESS ACT OF 1994" IS A NECESSARY TOOL WHICH MUST ALSO BE EMPLOYED TO NOT ONLY ASSIST THE VERY LIMITED NUMBER OF COMMUNITIES WHICH ARE

EVENTUALLY DESIGNATED AS EZ'S AND EC'S, BUT ALSO THE HUNDREDS OF COMMUNITIES WHICH WILL APPLY BUT NOT BE DESIGNATED. ALL OF THESE AREAS SHARE THE COMMON NEED TO ENCOURAGE THE CREATION AND GROWTH OF LOCAL SMALL BUSINESSES, A NEED WHICH WILL NOT BE SATISFIED BY ANY FEDERAL ECONOMIC DEVELOPMENT PROGRAM ALONE.

IT IS FOR THESE REASONS THAT THE NATIONAL LEAGUE OF CITIES AND THE UNITED STATES CONFERENCE OF MAYORS STRONGLY SUPPORT S. 1825, AND URGE EVERY MEMBER OF THIS SUBCOMMITTEE TO BE AN ORIGINAL SPONSOR OF A HOUSE COMPANION BILL WHICH SHOULD BE INTRODUCED EARLY IN THE 104TH CONGRESS. BOTH HOUSES OF CONGRESS MUST ACT EXPEDITIOUSLY TO RECONCILE THIS PROBLEM.

THANK YOU, MR. CHAIRMAN, FOR BOTH HOLDING A HEARING ON THIS VERY IMPORTANT ISSUE AND FOR THE OPPORTUNITY TO TESTIFY HERE TODAY. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS YOU MIGHT HAVE.

Table 3
Total Potential Additional Revenue from Mail Order Sales, 1994
(millions)

State	Adjusted Base*	Additional Revenue**
Alabama	$767.9	$48.6
Alaska	144.9	0.0
Arizona	752.4	44.4
Arkansas	425.5	19.6
California	7,503.2	482.8
Colorado	799.8	47.9
Connecticut	1,016.9	50.4
Delaware	168.4	0.0
District of Columbia	177.0	9.9
Florida	3,002.5	168.9
Georgia	1,403.0	72.9
Hawaii	281.7	9.8
Idaho	196.2	9.7
Illinois	2,878.5	233.1
Indiana	1,170.6	54.5
Iowa	589.5	28.3
Kansas	560.1	33.5
Kentucky	710.9	41.7
Louisiana	770.1	61.9
Maine	257.8	13.3
Maryland	1,291.6	60.1
Massachusetts	1,656.8	69.0
Michigan	2,110.6	108.4
Minnesota	1,030.6	53.1
Mississippi	420.8	28.0
Missouri	1,120.3	63.5
Montana	150.7	0.0
Nebraska	351.1	17.4
Nevada	309.5	17.4
New Hampshire	292.6	0.0
New Jersey	2,369.9	112.2
New Mexico	277.5	16.8
New York	4,898.9	359.4
North Carolina	1,385.5	71.1
North Dakota	122.6	5.8
Ohio	2,341.7	116.3
Oklahoma	596.0	41.8
Oregon	619.6	0.0
Pennsylvania	2,788.9	145.0
Rhode Island	233.9	14.2
South Carolina	659.9	31.3
South Dakota	134.7	7.3
Tennessee	1,001.1	68.8
Texas	3,627.5	235.2
Utah	318.5	16.8
Vermont	123.0	6.0
Virginia	1,506.9	59.9
Washington	1,199.2	76.2
West Virginia	312.4	18.6
Wisconsin	1,076.3	46.6
Wyoming	92.6	4.4
Total, all states	$57,998.3	
Total, tax states	$56,622.0	$3,301.5

* Adjusted for revenue currently being collected.

**Includes local taxes.

Sources: ACIR calculations based on *Portable Mail Order Industry Statistics, 1993 Edition; Fishman's 1992 Guide to Mail Order Sales;* Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1993 Edition, Volume 1;* and U.S. Department of Commerce, Bureau of the Census, *1987 Census of Retail Trade.*

September 12, 1994

The Honorable James Bilbray
Chairman
Subcommittee on Procurement, Taxation,
and Tourism
Committee on Small Business
United States House of Representatives
Washington, DC 20515

Dear Chairman Bilbray:

I would like to submit the following statement for the hearing on interstate sales tax collection in the House Small Business Subcommittee on Procurement, Taxation, and Tourism.

While on a trip to North Carolina a few years ago, my wife and I visited a furniture store to look for items for our winter home in Hilton Head, South Carolina. As you are no doubt aware, North Carolina is the furniture center of America. People come from all over America to buy furniture in North Carolina, drawn by word of mouth and various means of advertising.

As we shopped at one store in High Point, my wife and I found a number of furniture pieces that we were interested in buying. While considering the purchase, we were told by the sales staff that if this furniture were delivered to our home in South Carolina, no sales tax would be collected. This represented a savings of several hundred dollars, and became one factor in our decision to make the purchase. Subsequently, we concluded the purchase agreement, and the furniture was delivered to our home in South Carolina a short time later.

Approximately four years after making that purchase, we were surprised to receive a letter from the South Carolina Department of Revenue informing us that the furniture we had purchased in North Carolina was subject to South Carolina's use tax. (South Carolina had learned about the purchase when North Carolina audited the furniture company and shared the audit information with South Carolina.) In addition to the 5 percent tax, we owed interest and penalties because we had failed to pay the tax promptly. On our furniture purchase of some $10,000, the total amount we owed for tax, interest and penalties was approximately $700.

As you can imagine, we were shocked and upset at this news. We had no idea that we owed tax on this purchase. Like most consumers, we were accustomed to having sales taxes collected at the time of purchase, and it seemed odd to expect the customer to know when, where and how much tax to pay. And because the furniture salesman had told us that no tax would be "collected," we assumed that no tax existed.

I am not complaining about the tax itself. I certainly do not enjoy paying taxes, but had we known about this tax at the time of purchase, it wouldn't have been so bad. In that case, we could have considered the tax as part of the cost of the transaction and then made an

informed decision about whether to make the purchase or not. Indeed, it's quite possible that we would still have bought the furniture. But we were blindsided. We were led to believe that there was no tax, then told four years later that there was a tax. That simply is not fair.

The worst part of this situation is that we were expected to pay interest and penalties. As I told the South Carolina Department of Revenue, I felt that this was particularly unreasonable since we didn't even know we owed the tax -- and they didn't know we owed the taxes for four years. In the end, I won half the battle: they agreed to waive the penalties, but we still had to pay the interest.

I understand that the State of South Carolina cannot control what North Carolina merchants tell their customers. But the United States Congress can and should do so. I urge you to pass legislation immediately correcting this situation so that other consumers do not have the same bad experience we had.

In my opinion, you should require merchants who ship goods to other states to inform those customers that taxes may apply. The disclosure should be in writing, and the customer's signature should be required. Any merchant who fails to give the disclosure should have to pay 50 percent of any penalties or interest that occur. I believe this would discourage companies from failing to share important information with the consumer.

Thank you for the opportunity to share my thoughts with you on this issue. I hope that you will move quickly to ensure that other consumers aren't misled the way my wife and I were.

Sincerely,

John Dix

John Dix
273 Greenwood Drive
Hilton Head, SC 29928

341 N. Center Point Road
Portland TN 37148
September 8, 1994

Congressman James Bilbray
House Small Business Committee
U. S. House of Representatives
Washington, D. C. 20510

Dear Congressman Bilbray:

When I moved from Nashville to a small town a number of years ago, I discovered the convenience of mail-order buying. I buy several hundred dollars worth of merchandise per year. I am 75 years old and can no longer drive to the city to shop. I know there are probably thousands in my situation.

Several months ago I heard on our local news that people purchasing goods from mail order catalogs must pay State sales and use tax on these items. That was news to me. I, and I know many others, have always thought that merchandise purchased outside our state was not subject to sales tax unless such a vendor had a store within our state.

Since I have always tried to be a law-abiding citizen, I added up from my records all purchases made in recent years, figured the sales tax, and mailed a check to the State Department of Revenue. But what about those many people who still do not know they are liable for these taxes? This situation makes it unfair to those who are paying.

I once ordered many Christmas gifts from catalogs. Now I am inclined to send money to my out-of-town relatives, avoiding the hassle of tax-record keeping.

I believe it is the duty of mail order companies to collect sales taxes due, just as other stores and grocers do. Modern-day computers certainly make it easy for them.

I understand you are working on legislation to correct this situation. I hope you will succeed.

Sincerely yours,

Mamie R. Willis

Mamie R. Willis

I am submitting this statement for the record on behalf of Federation of Tax Administrators. I am the immediate past president of the Federation, and I serve as the Commissioner of the Tennessee Department of Revenue. I also served on the task force that was involved in negotiations with direct market representatives in 1992. I have written the Subcommittee a separate letter that explains those negotiations, and the states' final response to the industry.

The Federation is a not-for-profit association of the chief taxation and revenue agencies in the 50 states, the District of Columbia and New York City. FTA's primary missions include improving tax administration through education, research, and coordinating activities among the states and between the states and the federal government.

The Federation has consistently supported Congressional legislation that would require out-of-state sellers to collect the existing sales and use tax from their customers, and we would like to thank the Subcommittee for considering the difficult issues that face retailers and governments alike on this matter.

A use tax is imposed on a product purchased in one jurisdiction for use in another jurisdiction when no sales tax was paid in the jurisdiction when purchased. State and local governments have use taxes to prevent sales tax avoidance. If there were no taxes imposed on goods purchased in other states, residents could circumvent all sales taxes by shopping outside their state. In each of the 46 states (including the District of Columbia) with a sales tax, there is a corresponding use tax imposed at the same rate.

State tax administrators are increasingly concerned with the problem of untaxed mail order and other types of direct market sales. The 1967 U.S. Supreme Court decision in *National Bellas Hess v. Illinois Department of Revenue* said that states themselves do not have the authority to require out-of-state sellers to collect use taxes from states' customers, if a seller's only contact with those states is shipping in goods by the mail or by common carrier. This decision was upheld in 1992 in *Quill v. North Dakota.* The Court also made it clear in *Quill* that Congress did have the authority to require this tax be collected.

Yet in-state retail sellers have always had to collect this tax. As a result of these decisions, for the past 27 years, the tax agencies have struggled to apply their sales and use tax laws in a fair and administrable manner. We have left no possible collection mechanism untried. We have:

- undertaken extensive court challenges to define our authority on this interstate issue as precisely as possible,
- educated our taxpayers,
- offered them amnesties,
- tried to make it easier for individuals to make payments,
- shared audit results with other states,
- criminally prosecuted cases of fraud,
- stopped trucks at our state borders and used their invoices to identify sales,
- and encouraged voluntary collection by businesses by building sophisticated collection and registration programs and engaging in lengthy negotiations and dialogues.

These efforts are costly and they have brought in only a tiny percentage of the uncollected tax. Just to mention one example, the State of Florida recently launched an expansive collection program that, among other things, included direct mailings to 11,000 individuals who were identified as mail-order clients. From this mailing, only $7,600 resulted. Sending out bills based on examining invoices from every truck that crossed the

Florida border brought in only $50,000. Florida estimates it loses more than $200 million a year in uncollected taxes on out-of-state purchases.

The State of Maine requires their taxpayers to state the amount of their use tax purchases on the annual income tax return. Zero is permitted, but if no number is entered on the line, an amount equal to .04 percent of the state adjusted gross income is automatically imputed. This program has been touted by the direct marketing industry as a "successful" approach that, should all states adopt it, would "solve" the problem. Yet there are nine states with no broad-based income taxes. And even in Maine, in the four years this program has been in place, fewer than one return in four includes any use tax payment. I challenge anyone to argue that any tax system that has such a low voluntary compliance rate is successful or desirable.

Even those few individuals who understand this tax obligation usually refuse to pay voluntarily because they understand that the odds on "getting caught" are almost nil. Quite simply, there is no efficient or administrable way to collect this tax from individuals unless we are able to collect it at the time a sale is made.

States have suffered on two fronts. First, they have lost the ability to collect tax dollars -- even though the taxes have always been due to the states -- that should have been available to the legislatures to pay for schoolchildren's needs, provide services for the elderly, succor fledgling businesses, and generally support their citizens by providing for police and courts and by building roads, airports and parks and other infrastructures that make it possible for the economy to grow.

Second, state tax administrators have been forced to place a collection burden on one type of seller while being denied the authority to place an identical collection burden on a different type of seller.

Both sellers compete in the same marketplace, both rely on the same state systems to support that market -- including the courts and the roads and the landfills -- both pay property taxes on their buildings and employment taxes for their workers. Both have to collect shipping and handling, either by stating it separately or by including it in the price of goods sold. But only one has to collect a sales tax, with a median state-only rate of 5 percent, from their customers.

In this country, the average profit margin for a small business is often 5 percent or less, if the business is managed carefully. Thus, it is often the tax collector's inability to administer this tax fairly and impartially that can spell the difference between failure and success for a Main Street retailer. We are daily falling farther behind in our efforts to keep these Main Street retailers as a healthy, vigorous component of our economic structure. We strongly believe that such economic shifts should be caused solely by market factors and individual business acumen, not by uneven tax collection burdens.

This problem applies not only to the traditional kinds of direct marketers such as catalog sellers and "toll-free" television commercials. There is another kind of direct marketer, the border seller. These are sellers located near a state border, or who advertise heavily in a regional area involving many states. These sellers market their goods to individuals who drive to the store or warehouse, then have the items shipped home to a different state. We have countless examples of these stores that push the "tax-free" nature of their business, or of customers who shop at those stores because of the tax "savings." High-priced ticket items often purchased from border sellers include furniture, appliances, electronics, furs and jewelry.

Finally, I would like to address the direct market industry's arguments regarding the complexity, difficulty and expense of collecting this tax from their customers. I believe the most compelling and logical argument comes from the fact that a substantial number of direct market sellers, particularly mail order sellers, already collect this tax as a matter of routine. Some do so because they have a presence in the state that makes them subject to the state's authority. Some wish to avoid financial disasters in future years. (There have been cases of a company's sales force or catalog distribution personnel establishing a presence in a state without realizing the tax consequences, causing the seller to become liable for all the sales and use taxes it should have collected from its customers over the years.) Some sellers collect the tax as a customer service, and others do so because they wish to be good corporate citizens.

Regardless of the reason, the simple fact is there are many thriving companies that collect this tax in most or all states. Confidentiality of tax information generally prohibits us from naming examples. However, by looking at the order form in a catalog, you can see which firms collect taxes in which states. Those mail order companies that collect taxes range all the way from Sears down to the Boy Scouts of America. It can be done, it is not prohibitively expensive, and it is not difficult.

More specifically, it is not difficult to calculate the applicable tax based on the customer's address. According to a recent article in Catalog Age, one of this nation's best-known catalog sellers already uses computer software to handle its Canadian sales by address. Legislation currently in the Senate, and also legislation that has been before the House of Representatives, also would give sellers an option of collecting one rate per state, a simple solution not available to in-state sellers.

There are other legislative adjustments that could easily dispose of any remaining objections. A state's discount to merchants could also apply, giving direct sellers in those states financial compensation for collecting the tax. Also, legislation could allow these taxes to be paid to the states on a quarterly basis, further compensating the sellers for their expenses by allowing them use of these tax dollars for up to three months. Sales taxes from most in-state sellers are collected on a monthly basis.

Start-up businesses, mom-and-pop efforts, and persons who have a mail order business as a supplement to income could be protected completely by an appropriate de minimis. Small businesses could be exempt from collecting the tax. The de minimis currently in S. 1825 is one that would address the retailers' needs for a fair playing field, would exempt out the vast majority of companies, and would still permit the collection of most of the tax dollars. Under the Senate bill, only when a company's presence in a state grows to $100,000 annually would it have to begin collecting tax from customers in that state (unless a company's interstate sales grow to $3 million, in which case it should well be able to begin collecting taxes from all its customers, as the bill requires.)

The issue of shipping and handling deserves further elaboration. The direct marketers say they don't have a competitive advantage because they charge customers shipping and handling on top of a purchase price, and this charge more than offsets the use tax. This is a disingenuous argument for at least two reasons.

First, it's inappropriate to suggest that a legally-imposed tax should be used to offset a cost that occurs because of a choice made about the way to do business. Second, in considering the comparative cost burdens of a main street retailer, you can't stop at consider only the shipping and handling expense, but must also look at all their expenses, including a sales force, rent on floor space, repair facilities, and so forth.

As state authorities testified on this issue before the House on other occasions, the time is long overdue for correcting the inequities caused by the states' inability to require mail order companies to collect tax on their sales. It is time to even the playing field, and there simply is no longer any legal, logical or social reason to further delay taking this action.

Joe Huddleston, Commissioner
Tennessee Department of Revenue
Immediate Past President,
Federation of Tax Administrators

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QUALITY FORESTRY, ENGINEERING AND ENVIRONMENTAL EQUIPMENT SHIPPED WORLDWIDE

October 12, 1994

Congressman Jim Bilbray, Chairman
Subcommittee on Procurement, Taxation and Tourism
Small Business Committee
U.S. House of Representatives
B363RHOB
Washington, D.C. 20515

Dear Congressman Bilbray:

It is my understanding a Congressional hearing on Federal use tax legislation was held September 27, 1994. I have been asked to provide a letter of testimony outlining the burdens of collection and other problems associated with use tax collection on direct-marketing companies.

Enclosed is a package of information about this subject. I will not dwell on the general information contained in that package, but I do want to relate to specifics our company has experienced. Forestry Suppliers, Inc. is a business-to-business direct marketing company established in 1948. For many years, our company did collect and remit sales and use taxes to ten states other than our resident state of Mississippi. This practice was discontinued in 1978.

The problems associated with collecting out-of-state taxes were horrendous. The taxing state only wanted the revenue. The needs of our company to help get them their money were ignored. Our company was seldom, if ever, promptly notified of changes in their individual tax codes. We were continuously battling the increasingly difficult task of compliance.

We were never sure of questions like:

- What is their current tax rate? Many times their Legislature would make changes, yet we would not be notified. We learned of this when "we remitted the wrong amount". Since we were not resident in that state, they had no plan or means to notify us of changes.

- What local taxes are applicable?

- Is the item sold taxable in that state? In some states an item's taxability is determined by a general category. For example, in some states, food, clothing, etc. may not be in a taxable category. In other states, the taxability may be determined by the use of that product. Seed, fertilizer, herbicides and other products used for commercial agricultural use may not be taxed, however, those same items purchased for a home gardener would be subject to sales tax. The taxability may be determined by the

purchaser. Some counties, cities and school systems pay taxes like residents. In other states, special deals have been made with industry where that industry may pay some flat rate of tax in lieu of a point-of-sale tax. Some states have special tax rates for "protected" categories. Which apply?

- Are shipping and handling charges taxable in that state?

- Is the tax due to the state of purchase or to the state of delivery? For example, a customer in state "A" orders from a direct-marketing company in state "B", but the customer has the items delivered to someone in state "C". Who gets taxed? Which state gets the remittance?

- What are the tax filing dates?

- What tax filing forms are used?

- How are direct-marketing companies subject to audit?

- What penaltities are imposed on out-of-state direct-marketing companies?

These are but a few of the difficulties we encountered in trying to collect and remit sales tax. This list could go on and on and on.

Answers to each of these questions are specific to individual states. Each of these questions have answers. However, in our experience the states have never shown the slightest interest in answering these questions or in helping us as an out-of-state direct-marketing company answer these questions in order to make our tax collecting as easy and as inexpensive as possible. There were no efforts or procedures to compensate us for our efforts.

Not only do the tax calculations impose undue burdens on the purchaser and the direct-marketing company, the burden of uncollected taxes falls upon the direct-marketing company. Suppose a customer sends payment with his order but underpays by $1.43 because of an incorrect tax calculation. The direct-marketing company has two choices. The company can incur the expense of trying to collect the tax and lose customer's future business and goodwill because of being forced to pursue this seemingly petty problem. Or, the company can forego the costs associated with collection and loss of customer goodwill and simply pay the taxes out of its profits. In either case, why should the direct-marketing company bear this burden?

The seemingly small amounts of taxes that might be incorrectly calculated or failed to be calculated may seem insignificant on a single order basis. However, our company processes approximately 12,000 orders per year that are accompanied by a check. Of these orders, approximately 50 percent will have errors in calculations. These errors could come from a number of sources. Prices may have risen; reduced sale prices may temporarily be in effect; shipping rates may have changed since the catalog was published; shipping companies may have imposed special requirements; ect. Regardless of the reason for the miscalculation, our company is solely responsible for accepting or not accepting that order for the amount of payment that accompanied the order. If we feel the order is sufficiently

profitable, or if sufficient good will is to be gained, we can accept the order for less than normal profits. Or, we can make a decision to notify the customer of these additional costs and give the customer the ability to cancel or agree to the additional cost before shipment. These choices are not possible nor should the direct-marketing company have to make these choices with tax collection responsibilities.

Mr. Bilbray, I'm sure you have heard a lot of testimony from both sides. Our experiences over many years of collecting these out-of-state taxes have shown us costs incurred for out-of-state sales tax collections are immeasurable and the burdens are onerous at best.

I do hope this information is helpful to you.

Sincerely,

FORESTRY SUPPLIERS, INC.

John R. Gwaltney
President and CEO

JRG:jf

Enclosure

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QUALITY FORESTRY, ENGINEERING AND ENVIRONMENTAL EQUIPMENT SHIPPED WORLDWIDE

October 1994

Facts and Fallacies of Collection of Sales/Use Tax by Out-Of-State Mail-Order Companies

State tax commissions have pushed the U.S. Congress to pass legislation that would require Mail-Order companies to serve as tax collectors for 46 states. If enacted, this type of legislation would be abusive to consumers, businesses, the U.S. economy; would be unconstitutional; and would provide little, if any, real revenue to the states' coffers.

Let's examine the facts and fallacies of such legislation.

I. Lost revenue predicted is grossly over-estimated.

   A. A 1991 study by ACIR (Advisory Commission on Intergovernmental Relations) estimated $3.08 billion in lost tax revenues nationwide. Mississippi's share of this would be $27.3 million. This study was used by the National Association of Tax Administrators (NATA) to support their request for legislation.

   Problems with the ACIR study were:

   1. ACIR study included sales by smaller companies that would be exempt from proposed legislation.

   2. ACIR study included sales by Mail-Order companies that are already collecting taxes. These companies have stores in multiple states and collect taxes from sales in those states (i.e. Sears, JCPenney, Eddie Bauer, etc.).

   3. ACIR study did not figure that Mail-Order companies are voluntarily increasing "taxable" sales because the Mail-Order companies are establishing more stores in more states. Therefore, the "lost" revenue is on the decline.

   4. ACIR study included sales of goods that are exempt from tax by state regulations. These regulations vary tremendously from state to state.

   5. ACIR figures assumed that every penny of tax revenue would be collected.

   6. ACIR study did not include the cost to the state to inform, monitor compliance of, and audit the hundreds of out-of-state Mail-Order companies.

7. ACIR did not include the effect the cost of compliance would have on the income tax the Mail-Order companies would pay to the resident state (i.e. cost to comply would lower profitability, thus reduce the income tax paid to the state). The resident state that provides service to the Mail-Order company loses revenue so the Mail-Order company can comply with rules to collect for states that provide no services.

8. ACIR study did not include loss of Mail-Order companies and jobs if Mail-Order companies could not exist and the costs these losses would have on the revenues of the states in which the Mail-Order company was resident.

9. ACIR study did not include the cost of the repercussions on associated industries, i.e. printing, direct mail marketers, shippers, box makers, paper industry, and suppliers of merchandise to Mail-Order companies.

10. ACIR study did not include the losses due to reduced personal income taxes and unemployment.

B. A study by the Nathan economic consulting firm in 1991 calculated only $1.38 billion in lost tax revenues nationwide. The potential for MS was $14.1 million. An overwhelming percentage of total revenue given would go to only four or five states. The Nathan study did correct some flaws in the ACIR study, but it did not adjust for administrative costs, cost of enforcement, reduced corporate tax revenues, increased unemployment and reduced personal income tax revenues.

C. Mississippi's claimed share of lost revenue was approximately $27.3 million per year. With a tax rate of 7 percent, residents of MS would have to spend $390 million with out-of-state Mail-Order companies. How realistic is this? Mississippi's 2.6 million people, with an average per capita income of approximately $14,000, would have to spend approximately $150 per person with out-of-state Mail-Order companies. This does not include what they would spend with in-state companies.

Mississippi collected approximately $1.29 billion in sales tax in fiscal 1993. The net revenue (as calculated by the Nathan Study) to be gained would be less than 1 percent.

II. This type legislation would be abusive to consumers.

A. The repercussions of this type legislation fall most heavily on the poor, elderly, physically handicapped, and those isolated by geographical location. They fall hardest on those who can least avoid it. A study showed 45% of individuals with income over $25,000 bought by Mail-Order, but 30% of those with incomes under $20,000 also bought by Mail-Order. Mail-Order shopping is not reserved for the wealthy. Many people depend on Mail-Order companies for sources of items for

every-day living (medical supplies, clothing, gifts, even food). Mail-Order companies are the only sources for many specialized and hard-to-find items that Main Street (i.e. in-state, local) merchants can't afford or refuse to handle.

B. This legislation would cause unnecessary aggravation and confusion for customers. Mail-Order shopping's simplicity and convenience are its most attractive features. As the legislation is proposed, every order would have to be figured with difficult calculations (see below) to determine the correct tax.

1. What state tax rate is applicable (some tax rates vary within state by address)?

2. What local tax is applicable?

3. Is the item taxable in the state:

a. By category? Food, clothes, agricultural products and many other products vary from state to state.

b. By use? Taxable if personal; not taxable if business, sometimes vary by profession, all vary by state?

c. By purchaser? Some buyers are taxed, others are not. Again, it depends on the state.

4. Are shipping/handling charges taxable? Again, these vary by state.

5. Is tax due to the state of purchase or to the state of delivery (customer in state A, orders from Mail-Order company in state B, but customer has items delivered to state C)?

6. Is the tax a "sales" or a "use" tax? Are they handled the same or differently by the state?

C. Consumers of Mail-Order companies would be forced to pay higher prices in order for Mail-Order companies to comply with the law. Estimates are 10-20% increase in operating costs to comply with legislation. This means higher costs to consumers.

D. Fewer choices for consumers. Many Mail-Order companies will go out of business because of expense to comply. When these Mail-Order companies are out of business, then their goods are no longer an available choice.

Most vulnerable are "niche" marketers-- those that offer and survive on sales of "hard-to-find" items. Sales of "hard-to-find" items are low in volume, so Main

Street marketers will not offer these items. Because "niche" Mail-Order companies cover a much larger geographical area, the offering of "hard-to-find" items can be justified.

Many of these "hard-to-find items" are critical to certain industries. Those industries would suffer if not for the Mail-Order companies that offer the "hard-to-find" items the industries need. (Example: companies that specialize in scientific equipment, educational supplies, etc.)

III. Unfair competition to Main Street merchants has been claimed as a reason for support of this type legislation.

A. In two separate surveys by the National Federation of Independent Businesses (NFIB), 82% and 59% respectively voted "NO" to the question of "should Mail-Order companies be required to collect sales taxes from out-of-state sales". Of NFIB's 600,000 members, less than 0.2 percent are Mail-Order companies. Over 99 percent are Main Street marketers. It doesn't sound like the majority of Main Street marketers feel there is a problem. Maybe the Main Street marketers are the banner for the state tax commissions ploy.

B. Main Street marketers claim Mail-Order companies have a price advantage over them equal to the state tax rate. Shoppers-by-mail pay shipping/handling charges that are usually higher than the tax rate difference.

C. Most people do not shop by mail for the tax savings. Less than 13 percent in a Gallup Survey admitted they consciously used tax savings as a reason to shop by mail.

D. People do shop by mail for one or more of the following reasons:

1. Convenience-- Main Street marketers decide when to open/close. Mail-Order customers buy at their own convenience, not conveniences imposed on them by Main Street marketers. Mail-Order customers can shop from their own homes and businesses, and not contend with traffic, crowds, weather, crime, etc.

2. Better service-- shoppers by mail do not have to rely on the attitudes of Main Street marketers' sales people. Items offered by Mail-Order companies are usually immediately available. If a product is out-of-stock from a Mail-Order company, it will be shipped to the customer when available. If a product is out-of-stock with a Main Street marketer, the customer will normally have to "check back", maybe many times, to obtain the merchandise.

3. Customers pay for the high overhead of "show" required by Main Street marketers to lure customers to their stores.

4. Quality of merchandise is often better from Mail-Order companies. Prices may or may not be lower than Main Street stores. Mail-Order companies do not rely on discounted prices to exist, and discounts are not the main attraction to Mail-Order companies.

5. Few people shop Mail-Order for lower prices alone.

6. Hard-to-find items are available from Mail-Order that Main Street marketers would not carry because Main Street stores couldn't sell enough to justify.

D. Tax collection is not supposed to be a way to make one industry competitive with another.

E. Main Street marketers do not like competition further down Main Street. Will this be their next area of attack? Take this problem one step further and suppose a Main Street marketer in one local jurisdiction of a state sold an item to a resident of another local jurisdiction of the same state. Would it be the merchant's duty and responsibility to collect the "use" taxes from the customer and remit those "use" taxes to the appropriate jurisdiction? Would Main Street merchants be willing to collect and remit those taxes?

IV. How would this type legislation be unfair to Mail-Order companies?

A. Main Street marketers have one tax rate, known by every customer. Merchandise and dollars are exchanged at the same time with the total amount known and agreed upon by the Main Street marketer and the customer. The Main Street marketer doesn't have to follow up to collect tax after the sales transaction is completed.

Mail-Order companies would have to collect a minimum of 46 state tax rates and potentially over 6,000 local tax rates, often confusing because of state and local tax regulation variations (see II.B.). To illustrate the complexity of the many state sales tax rules, a company in Pennsylvania makes a living from production and sales of a multi-volume set of books to try to keep track of state tax regulations. AT&T employs approximately 76 persons to handle sales and use taxes and files over 9,000 returns annually.

Main Street marketers are subject to one state's rules and audit. Mail-Order companies would be subject to 46 states and thousands of local rules, filings and audits.

From our own experience, states are extremely derelict in informing out-of-state Mail-Order companies regarding what the rules are, when they change, etc. Yet, all states want out-of-state Mail-Order companies to promptly comply as if the out-of-state companies knew all the rules.

B. Main Street marketers receive state services from the only state they collect taxes for. Mail-Order companies receive no services, except from their resident state, but would be required to collect for all.

C. Costs of Mail-Order companies to collect from out-of-state is over 6 times the costs of in-state collection by Main Street marketers (per study by Touche Ross).

Most Mail-Order purchases are prepaid, whereby a check accompanies the order for merchandise. If the amount of the check is insufficient to cover the tax, the Mail-Order company must incur additional expense in an effort to collect. In many instances, the cost to collect will be greater than the tax to be collected. The Mail-Order company can try to collect the taxes (at the company's expense), aggravate its customer, and lose more business, or the Mail-Order company can elect to pay the taxes from profits. Either way, the Mail-Order company loses. Sales lost due to customer confusion, aggravation and frustration would be immeasurable.

D. The cost to implement a computer system to try to comply with these many rules would force many Mail-Order companies out of business or restrict profits so as not to be worthwhile to continue in business.

E. Cost of advertising space to explain complex tax rules, rates, calculations, etc. would be tremendously expensive. Catalog space is valuable to Mail-Order companies as store space is to Main Street marketers.

F. In many cases, the out-of-state Mail-Order companies would have to pay to be registered to collect and remit taxes to the states and local taxing agencies.

V. Impact on state revenue.

A. The states that are pushing for this type legislation have not considered the total economic impact on themselves. They have not considered the following costs.

1. Administrative costs to monitor compliance by hundreds of out-of-state Mail-Order companies.

2. Administrative costs to properly and timely inform out-of-state Mail-Order companies of changes in tax rates and other tax regulations.

3. Administrative costs to promptly distribute information, instructions, etc. to out-of-state Mail-Order companies.

4. Processing costs to review thousands of tax returns and other filings.

5. Costs for auditing the hundreds of out-of-state Mail-Order companies (including travel, additional personnel, etc.).

6. Costs for enforcement of the out-of-state Mail-Order companies.

B. The states that have resident Mail-Order companies will lose revenue from:

1. Lost revenue because of in-state Mail-Order companies' closings.

2. Lost revenue because of supporting suppliers' closings.

3. Lost jobs from Mail-Order companies.

4. Lost jobs from supporting suppliers to Mail-Order companies.

5. Unemployment compensation paid to employees of Mail-Order companies forced out of business or forced to reduce their work forces.

6. Unemployment compensation paid to employees of supplier businesses that supply and depend on Mail-Order companies that are out of business or forced to reduce their work forces.

7. Reduced income taxes from in-state Mail-Order companies because of increased costs to comply by Mail-Order companies.

8. Reduced income taxes from in-state suppliers of goods/services to Mail-Order companies.

VI. Cost to Federal Government.

Lost revenue would be for the same reasons that states lose revenue from in-state Mail-Order companies.

VII. Abusive to United States Economy.

A. Lost jobs, because Mail-Order companies and their supporting suppliers would be forced to close or reduce work forces because of the high compliance costs.

B. Impose unproductive costs and inefficiencies on a major U.S. industry.

C. Threatens many small and mid-size businesses (Mail-Order and supporting suppliers of goods and services to Mail-Order businesses).

D. Reduce profits and spending by Mail-Order industry and their suppliers.

The Mail-Order industry does not try to "take" revenue away from the states. That is between the taxing states and the residents of those states.

The Mail-Order industry should not be the tax collecting agent for any state from which the Mail-Order company receives no state services or benefits, and has no vote. The Mail-Order industry should not have to increase its prices to comply just so it can be a "free" tax collector for every state.

Mississippi collected $1,290,548,234 in sales taxes in Fiscal Year 1993. The $27.3 million purported lost revenue represents less than 2.1% of the total sales tax revenue of Mississippi. Is this small amount really worth the extreme cost to consumers, the Mail-Order industry, other forms of state revenues, Federal revenue, and the U.S. economy? If the states feel they are losing so much revenue, then let the states find a way to get the tax from their own residents who "owe" the tax. This type legislation follows the rationale of "get someone else to do the dirty work-- especially if it doesn't cost me anything (i.e. votes)". Let the states incur the cost to collect, monitor and enforce. Let the states face up to their responsibility and not lay the burden and blame on the out-of-state Mail-Order companies.

FORESTRY SUPPLIERS, INC.

John R. Gwaltney

John R. Gwaltney
President and CEO

JRG:jf

FINGERHUT COMPANIES, INC.

October 6, 1994

Robert C. Kieffer
Assistant
General Counsel

The Honorable Jim Bilbray
Chairman
Subcommittee on Procurement, Taxation and
Tourism
Small Business Committee
U.S. House of Representatives
B363 RHOB
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing in regard to federal use tax legislation as discussed last week in the Procurement, Taxation and Tourism Subcommittee hearing. I would appreciate this letter being entered into the official record of the hearing.

Fingerhut Companies, Inc. is a multi-media direct marketing company selling a broad range of products and services to consumers via catalog, television and other media. The Company employs approximately 9500 people in Minnesota, Tennessee, Utah and Wisconsin. Fingerhut is in the process of establishing S The Shopping Network, a 24-hour home shopping channel, in Nevada.

Even though Fingerhut is one of the nation's largest direct marketers, mailing over 476 million catalogs and other promotions last year, the obligation to collect taxes on behalf of 46 states and 6000 local jurisdictions would be extremely costly and burdensome for it. For small businesses, however, it would be nearly impossible. With all the varying rates, exemptions and filing procedures, compliance would very quickly become a prohibitively expensive and complicated task, forcing many smaller companies out of business.

With the passage of federal legislation, direct marketing companies would become responsible for collecting use taxes on behalf of all jurisdictions, even those in which they have no physical presence. In the case of companies whose customers pay by check and fail to remit the tax, the direct marketer would also be forced to absorb the

cost and remit the tax itself. In Fingerhut's case, over 95% of incoming payments are made by check or money order.

With the already high costs of fulfillment inherent to our industry and the certainty of at least a double digit postal rate increase in 1995, we simply cannot absorb more costs. This legislation would not only impose unfair costs and add administrative burdens on Fingerhut and other direct marketing companies but its inevitable effect on our profitability would necessarily force us to spend less with our myriad vendors such as printers, paper suppliers and product suppliers affecting their profits as well.

Because there are other, fairer options to explore such as a voluntary collection agreement negotiated by representatives of the states and the industry, but entered into by individual companies, I urge you to oppose this legislation.

Sincerely,

Robert C. Kieffer

RCK/rlm

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